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**MAINTAINING AMORTIZATION BASES AFTER FULL FUNDING
AND THE OPERATION OF THE RECONCILIATION ACCOUNT**

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Confused about whether to "wipe out" amortization bases or the reconciliation account after hitting the full-funding limit? Unsure how the equation of balance operates after full funding? Unsure how excess interest is calculated on late quarterly contributions? Not quite as esoteric as how many angels can dance on the head of a pin, but close!

MR. HAROLD ISAAC BARR: Surely you'll find some part of this interesting because a variety of related topics are going to be covered. I'm an actuary at Wyatt Worldwide in Dallas, TX, and Marilyn Janzen is a senior actuary at The Principal Financial Group in Des Moines, IA.

MS. MARILYN F. JANZEN: We had a difference of opinion as to whether our topic was going to be maintaining amortization bases *after* full funding and the operation of the reconciliation account, or maintaining amortization bases after full funding *and* the operation of the reconciliation account. This schizophrenic kind of idea came through the program summary of what we were going to be covering. We decided that our focus will be on the equation of balance and how different pieces of the funding standard account (FSA) and the unfunded accrued liability (UAL) are tied together. In addition to that, we're going to take some time to look at how pieces of the General Agreement on Tariffs and Trades (GATT) have specifically addressed the charges and credits that flow through the FSA and how this all is going to balance in the end.

In the beginning, the UAL equaled the outstanding balance. As the IRS has imposed different limits or added additional charges to the FSA, things have needed to have help in becoming reconciled.

The equation of balance is an idea that's found on the Schedule B, and basically it's the method whereby you relate the UAL and the FSA. The simple balance equation says that the UAL equals the outstanding balance minus the credit balance. And during the first years following ERISA, that was fine. Everybody was comfortable and things were great. But then we had to make some changes.

The first thing that happened was we had to address full funding. What happened when your plan's UAL became equal to zero? And then on the other hand, the IRS and Congress decided that plans needed to have some additional charges. They didn't think that some of the underfunded plans were funding fast enough so they increased the charges. As a result, the UAL no longer equaled the outstanding balance minus the credit balance without adjustments.

What are the full-funding limits? The full-funding limits that we're going to be talking about, which Harold will be addressing, are the ERISA full-funding limit and the Omnibus Budget Reconciliation Act (OBRA) full-funding limit. Both of these are modified slightly by GATT, and he'll cover how those changes flow through.

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To reconcile what's going on after the full-funding limit, it's necessary for the equation of balance to reflect a full-funding credit. The results of this can sometimes be somewhat surprising.

The next area is additional charges. The additional funding charge (AFC) will collectively include all the additional things that affect the FSA because of 412(l). It will include unpredictable contingent event benefits (UCEBs), which I believe most of us have not seen. We will not cover how to calculate these charges.

The last section is the interest penalty charges under 412(m). This includes the interest on required installments under 412(m) as we've known them since 1988. The second is the liquidity shortfall that was added by GATT. There are additional charges that can be produced by the unpredictable contingent event calculation but again, those are so obscure that I'm not going to deal with them. And the last kind of charges are very unusual. This happens when a funding waiver amortization is flowing through your FSA. This is an extremely rare event because the conditions for getting a waiver approved are so stringent that most people probably throw up their hands and say that this isn't even going to work anyway.

FROM THE FLOOR: Aren't there still waiver bases that were amortized over 15 years?

MS. JANZEN: That's true, but those were amortized under the original interest rate, and so they don't cause any special problems. Special calculations occur only on the waivers that have the new specified interest rates.

When you're dealing with the equation of balance, you need to move from the current year (Y) to the next year ($Y+1$). The standard approach was to begin with the UAL at the beginning of the year, increase it with interest at the valuation rate, add the normal cost with interest to the end of the year, and subtract the contributions plus interest. That would give you what the UAL was at the end of the year. That is still the way that you carry forward your UAL.

The outstanding balance is carried forward by increasing it with interest at the valuation rate and deducting the amortization payment with interest to the end of the year.

The credit balance has been the balancing item for the very simple case where there are no adjustments. Basically it's the credit balance that you had at the beginning of the year, increased with interest, plus your contributions with interest, less your charges and credits to the FSA. These are the normal cost with interest and the net amortization payments with interest.

For the straight vanilla kind of equation of balance, I've set the formulas up in columns and tried to show you how they move through from one piece to the next. The middle column is what I would call the trick, because the sum of the pieces equals zero, but it helps make the grouping of items work. If you take your normal cost, all the charges that go through the FSA, and then you group together the pieces as they're operating in the UAL, you can see that it's very clean. The UAL moves with the changes in the outstanding balance, and you have the result that the UAL equals the outstanding balance minus the credit balance.

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Straight Vanilla

FSA	$UAL_y (1 + i)$	Reconcile
NC (1 + i)	$UAL_y (1 + i)$	UAL_{y+1}
- C - I		
+ AP (1 + i)	- $OB_y (1+i)$	- OB_{y+1}
$\frac{-CB_y (1 + i)}{-CB_{y+1}}$	$\frac{+Cb_y (1 + i)}{0}$	<hr style="width: 100%; border: 0.5px solid black;"/> - CB_{y+1}

So, $UAL_{y+1} - OB_{y+1} = -CB_{y+1}$
 $UAL_{y+1} = OB_{y+1} - CB_{y+1}$

The next section will be addressed by Harold. He'll talk about full-funding limits.

MR. BARR: You can see that there are explanations, depending on your interest and mortality assumptions, on how many different current liabilities you might come up with and what purposes you're going to use them for. For purposes of this class, we're particularly interested in two of them. The one that's used for the 150% current liability full-funding limit that was introduced to us under OBRA has not been changed by GATT. That one's still going to use whatever mortality you're using with your main funding method even if it's not the 1983 group annuity mortality GAM male and female tables. The specified tables are used for most purposes under GATT, including the current liability that you're going to use to calculate the 90% of current liability full-funding limit floor. Many of you devilishly tricky actuaries are using high interest assumptions with your main funding methods. But at the same time Congress has been warned that we won't tolerate Congress dictating what interest assumptions we use. They have determined that we're artificially making this full-funding limit too small and the full-funding credit is too large, allowing our clients to underfund their plans. They've introduced a full-funding limit in which they control the interest and mortality assumption that goes into this 90% current liability. Therefore, we've been undone, it's over now, we can't use that trick anymore.

For that current liability you must use the mortality they've dictated by regulation, the 1983 GAM for now. The highest interest assumption you can use this year is the 109% grading down over the years to 105% of the four-year weighted average of 30-year Treasury securities. The interest rate for the old OBRA 150% current liability full-funding limit can still be up to the 110%. That wasn't changed by GATT, and that will not be reduced in the coming years without more legislation.

So what are you going to do with these two current liabilities that we've just talked about? Well, you're going to calculate the old ERISA full-funding limit. I should give you a proviso here. Much of what I'm about to say has not been declared, even verbally, by the IRS. You're going to hear a lot of my opinion and conjecture. This conjecture is being used by my whole firm, which is one of the larger firms, but it could turn out to be wrong.

{Recorder's note: the draft of the 1995 Schedule B was available at the time this session was prepared for the *Record*. The draft does differ in some details from the proposed method covered here.}

MR. BARR: We'll find out eventually if and when they decide some of these details and let us know, but we believe that the ERISA full-funding limits and the ERISA full-funding credit are still calculated the same way they were even before OBRA came along; that nothing in OBRA or GATT changes that. We think that the new full-funding limit is going to be handled in the FSA as a separate offsetting item. But before I get into that, the current liability full-funding limit that was introduced under OBRA is calculated the same way as before, at least at first. Then finally, the full-funding limit floor, item three here, needs to be calculated.

Notice that before when we calculated the first two full-funding limits, we used the smaller of actuarial value of assets and market value of assets projecting to the end of the year. For the floor, we just use the actuarial value of assets. Projected market value to the end of the year is not specified anywhere and again, the purpose is to prevent the full-funding limit from being too low from a plan termination or current liability viewpoint. So the net full-funding limit before GATT was the smaller of those two full-funding limits that you're familiar with.

After GATT now, the net final full-funding limit is the larger of the pre-GATT full-funding limit or this floor. So as has always been the case, you've got the full-funding limit on the one hand that sets the cap on your maximum, but then you've got the FSA where you need to implement the minimum full-funding limit with credits or as we're about to see now, charges for the first time. I believe we're to continue to calculate the ERISA full-funding credit exactly the way we did before GATT and even before OBRA. You take the gross charges for the FSA. By gross charges I mean before we subtract the credit balance but after we've added on any of the late interest charges that Marilyn talked about. We take the ERISA full-funding limit with the assets adjusted by the credit balance and compare it with the gross charges to see if there's an excess. If so, you've got an ERISA full-funding credit and the prior amortization base table gets wiped out.

There are no amortization bases then at the beginning of the following year, with an exception of what we're going to get to shortly. Also, the accumulated reconciliation account balance gets wiped out. That has never been regulated or stated formally, but informally the IRS has told us that when you wipe out the amortization base table for full funding under ERISA, you also wipe out any of your reconciliation account items that you happen to have. Go back to zero and start again.

The primary driving reason that we believe the ERISA full-funding credit should not be disturbed by GATT, even though it's going to need to be offset and adjusted, is that if we don't keep calculating the full-funding credit the way we always have, we won't have the same clear, original law intact as to when you do and don't wipe out the bases and start all over again.

The current liability full-funding credit I've described needs to be adjusted for GATT. Start out with the preliminary OBRA full-funding credit, the FSA gross charges in excess of the OBRA full-funding limit, and then compare that with the ERISA full-funding credit, if any. In most cases you will either have an ERISA full-funding credit or an OBRA full-funding credit, but a comparison is needed if both are applicable. I'm calling this calculation the preliminary OBRA full-funding credit because next we'll get into the full-funding limit floor that GATT has added. We'll see again my opinion on how to handle the effects of that, and it could change the OBRA full-funding credit.

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First you calculate what I'm calling a preliminary GATT full-funding charge. Again, the GATT full-funding floor is 90% of the GATT basis current liability projected to the end of the year less the actuarial value of assets but no less than zero. The preliminary GATT full-funding limit charge is the excess, if any, of the GATT full-funding limit floor over the lesser of the ERISA full-funding limit or the OBRA full-funding limit. Compare that number with the sum of the ERISA full-funding credit and the OBRA full-funding credit calculated under prior law. If you have a GATT full-funding limit charge, you're going to have to offset your full-funding credits.

The preliminary full-funding limit was the smaller of either the OBRA full-funding limit or the ERISA full-funding limit. Throughout here, all these are with the assets having been adjusted by the credit balance. But if the GATT full-funding limit is higher than that, you are going to have to deposit enough to bring assets up to the GATT limit.

If that preliminary GATT full-funding charge is bigger than the preliminary OBRA full-funding credit, I believe that what's reasonable to do for purposes of the FSA is to wipe out the OBRA full-funding credit. If the GATT full-funding floor is larger than the current liability full-funding limit, then you don't have a current liability full-funding limit applying. So I'm saying that the OBRA full-funding credit would be changed to zero. If the preliminary GATT full-funding charge is less than the preliminary OBRA full-funding credit, then you have no full-funding charge and the OBRA full-funding credit gets reduced to the extent necessary by the GATT full-funding charge. If the floor is so big that it wants to push your full-funding limits up, then how are you going to make the FSA come out to reflect that? Well, if a full-funding limit requires you to enter a credit, then increasing that limit would require you to enter an offsetting charge. However, if the credit that you're offsetting for that charge is the OBRA one, well, neither one of those is important in and of itself. They're not triggering events to wipe out amortization tables; they don't have any real substance except that they will be in there making the account balance. I believe if you end up after all this with a GATT full-funding charge, you would amortize that over ten years. That's conjecture, the IRS hasn't spoken, but we try to reason out what it does after OBRA when it is interpreting the law and what's common here between this law and that law. It seems reasonable that it would have us amortize this charge over ten years also. If they're both going to be amortized over ten years, why not just let them offset? It would be silly to have both at the same time, because offsetting ten-year amortization bases represents essentially the same notion.

If after all those adjustments there is a surviving GATT full-funding charge and you don't have an OBRA full-funding credit, then that means basically that you must have an ERISA full-funding credit. The only reason you had this GATT full-funding charge number was to offset a full-funding credit. So you have an ERISA full-funding credit and a smaller GATT full-funding charge on opposite sides of the FSA. One of them says to wipe out all your bases that exist in the amortization table. The other one says to create a new base that you amortize over ten years. That's not unlike what happened under OBRA. If you happen to have an OBRA full-funding credit and an ERISA full-funding credit simultaneously, the IRS has told us that you wipe out all the old bases, but then the next year you have that one OBRA full-funding credit base. Similarly, we're suggesting what will probably come out of the IRS is that after you have an ERISA full-funding credit with an offsetting GATT full-funding charge, then the next year all your old bases will be gone but you'll have got one new base, which is a credit base. It's a charge the year that it emerges; the following year, it's a credit base to keep the equation of balance working.

So interestingly enough, if you have an ERISA full-funding credit that wants to bring your UAL exactly to zero but you have this offsetting GATT full-funding charge, what they're causing you to do under your funding method and assumptions is overfund your actuarial accrued liability. They are now requiring you to do the very thing that the ERISA full-funding limit was constructed to make sure you did not do.

FROM THE FLOOR: How could you have a GATT full-funding limit greater than the OBRA full-funding limit? GATT uses 90%, but OBRA uses 150%.

MR. BARR: There's a difference in interest assumptions and methods. As I said, the IRS knows that there are those who will sign Schedule Bs with unacceptably high interest assumptions under entry age or projected unit credit methods and, therefore, let plan sponsors get away with underfunding their plans. The IRS won't let us do that anymore. It is going to make us overfund that actuarial liability.

Because the IRS dictates the mortality and the interest assumptions for this calculation, depending on what happens you might see these charges even if you feel like you're using very reasonable assumptions.

If you had an OBRA full-funding credit, you're expecting to underfund your accrued liability. If the ERISA full-funding credit is present and also the current liability full-funding credit is present, you can expect to have an underfunded actuarial accrued liability again. That's really the opposite of what I was saying about the GATT situation. And it's worth mentioning that if you're calculating the full-funding credits and charges the way we think you should, if you have any interest charges or liquidity shortfall charges that we are going to get into shortly and so on, the full-funding credit is calculated so that it actually increases as those increase. Said differently, you can't calculate the final full-funding credits and charges on a valuation date before they have or haven't made the quarterly contributions, but you can calculate the full-funding limits. The credits will be adjusted to support those limits no matter what failures they make in meeting a quarterly contribution schedule or liquidity requirements or the like.

After the ERISA full-funding limit has applied, we all know that Revenue Ruling 81-213 tells us what kind of an actuarial gain/loss base we are going to create the next year so that we're starting off in balance now that the plan is no longer overfunded. Ruling 81-213, of course, was written before OBRA and before GATT, and so we have to extrapolate on what it's telling us so that the equation of balance still works. The loss base would be equal to the actual UAL plus the credit balance, but because of OBRA we must also recognize any OBRA full-funding base that exists, should you have had both full-funding credits last year. If you didn't have the OBRA full-funding credit but instead had the GATT full-funding charge, now that new base needs to come into the calculation, too. For spread gain methods, which are controversial, whenever you do set up a base, again the GATT full-funding charge or the OBRA full-funding credit will be new bases. You want the balance test to work, and the credit base for the GATT full-funding charge or the charge base for the OBRA full-funding credit must be taken into account.

MS. JANZEN: I'm not really going to spend any time talking about the details of the deficit reduction contribution charges. We will look at how those charges flow through the equation of balance. Because you have the extra charges, you have to make some kind of an adjustment. I'm going to use the AFC to lump those things together. One of the

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things that I will cover in more detail is what's going on with the 412(m) required installments. One of the real advantages about the changes in the Retirement Protection Act was that if the funded current liability percentage was more than 100% in the prior year, then finally there are no required installments. However, the law says there was no interest penalty. It didn't say there were no required installments; it just said there was no interest penalty. Then Revenue Ruling 95-31 made sure that people knew that the 100% rule means you don't have to make quarterly contributions.

For the purpose of calculating any additional interest charges for 412(m), you use the greater of the 175% federal midterm rate or the valuation interest rate. It would be fairly unusual at this time to have a valuation interest rate that's higher than 175% of the federal midterm rate, but I suppose some really creative actuary could be doing that. When you are doing the calculations, Revenue Notice 89-52 is basically unchanged, but there are some things that are going to be added by Revenue Ruling 95-31.

The liquidity shortfall is an unusual calculation. It's designed to make sure that plans that are severely underfunded are putting in enough assets to cover the expected outflow over the next year. It will be based on looking at an amount that's equivalent to the last three years of charges, with the idea that you should have at least that much on hand.

It's similar to the required installment for the rate of interest that's used, again the greater of 175% of the federal midterm rate or the valuation interest rate. Basically this calculation is done fresh every quarter. You start over again so you could have a liquidity shortfall one quarter and none the next quarter, even though you hadn't paid the prior quarter's liquidity shortfall. There are severe penalties, though, if you're thinking about this. The liquidity shortfall only applies to plans that have more than 100 participants or plans that are in a controlled group situation similar to the rules for 412(l). This can cause some very unusual results if a controlled group has small plans for each one of its locations.

The last item that could be an additional charge for 412(l) occurs because sometimes the waiver of funding deficiency is amortized at a higher rate of interest than the valuation rate. Over the last five years, there have been three different ways to calculate the interest for waiver of funding deficiencies. Originally, they were done with a 15-year period and you used the valuation interest rate. There are still a few of those waivers that have the last few years to go and basically you can think of those as being equivalent to any other outstanding balance that you have.

Then there was a very brief period where they used another special rate, and that lasted for about a year. Now you use the higher of the 150% federal midterm rate or the valuation interest rate. You carry forward the balance and recalculate the amortization amount every year based on the rate that's in effect at the beginning of the plan year. And so this is a calculation that has a lot of work to it because you have to keep reamortizing every year. This creates some unusual things going on in your equation of balance. Basically at the end, when you finally get your waiver amortized, you will find that you end up with a chunk of accumulated extra interest that you have paid because you weren't using the valuation interest, and that piece is going to stay with you until you get an ERISA full-funding limit.

What goes on with the equation of balance when you have additional funding charges. You start out with your beginning equation and we're looking at a case where you did have some additional charges from a prior year. Initially, your UAL is equal to the outstanding balance minus the credit balance and then minus the accumulated reconciliation account that you had at the beginning of the year. You carry forward your UAL and your outstanding balances in just the way that you have in the past, but what is going to happen with your accumulated reconciliation accounts? You're going to increase what you had at the beginning of the year with interest, and then you're also going to add the new charges that you have for the current year. The prior-year reconciliation account accumulates with interest, and then your new charges that flow through because of additional funding or interest penalties for the year are added up and accumulate for the accumulated reconciliation account (ARA) at the end of the year. On the Schedule B, they seem to be kind of split in terms of whether they want you to merge them together or whether they want you to show them separately. So you show them separately in one place and then you combine them in a different spot. You can keep track of them and you have to do this very carefully because you're going to have to do this somewhere for the next year's Schedule B.

If you ever have to do the reconciliation for waiver of contribution, I would suggest you look very closely at the instructions on the Schedule B.

MR. BARR: The 1994 Schedule B.

MS. JANZEN: Yes, the 1994 Schedule B for sure. In the UAL you're going to be contributing the amortization payment for your waiver balance at the beginning of the year on an end-of-the-year basis that includes the higher rate of interest, but the amount of interest that you charged to that beginning-of-the-year balance is only going to be based on your current valuation rate. And so you start to get into problems because not only do you have a higher interest charge, but you have a different amortization that underlies your valuation basis.

The waiver reconciliation outstanding balance is basically an item that you have to fill in on the Schedule B. You take what you had at the end of the prior year, you give it valuation interest, and you deduct the waiver amortization payment with interest at the special rate to the end of the year. Then you compare that with what you're going to show on your Schedule B that shows the waiver amortization outstanding balance. That will be what that outstanding balance is, and that's going to move during the year with the special high interest rate. You have to have several lines that are shown in the Schedule B to keep track of this.

Just out of curiosity, how many people have actually had a waiver? (Only a couple raised their hands.) In subsequent waiver years you have these existing pieces and you continue the process, but now you usually are dealing with interest rate double prime, because you have a new interest rate. So you have to take the amount that you had at the end of the prior year and process it in an equivalent manner. You just keep going and at the end of five years, you finally get rid of the amortization payments. Then you only have to deal with the excess interest accumulation, which again will stick with you until you finally get an ERISA full-funding limit.

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How do you calculate the additional interest charges for 412(m)? I'm not going to go into a lot of detail because we've been doing this since 1988. Later we will look at some of the changes that happened because of the liquidity shortfall calculation.

When you determine your required installments, you have to look at 100% of last year's charges or 90% of the current year's charges. It's getting more and more difficult to figure out what the current year charges are when you're trying to estimate what your amount is going to be.

In fact, if you haven't completed your required installment deposits for the prior year, you don't know what the interest penalty is going to be for that year. This occurs if you get to March and you're trying to tell your customer what he or she needs to deposit for the first quarterly requirement in 1995, for example. Now of course you're dealing with someone who hasn't made all of his 1994 payments anyway, but you need to make a good guess at what it's going to be. How do you do that? You have to calculate what the maximum interest penalty might be at that point, and then you have to base your calculation, your estimate for 1995, on that. Then when the company finally completes its 1994 required installments, you can say, "OK, I know what that 100% amount is, now we can deal with how to calculate the 1995 amount." You feel like you're kind of paddling upstream when trying to deal with these amounts because you can't give the client a precise answer. This is very frustrating.

MR. BARR: Marilyn, when you say "assume the maximum," do you mean that the company doesn't do it until September?

MS. JANZEN: Yes, it won't make its last contribution that it has to pay until September. One of the good things about your contributions is that if you do contribute more than the required installment, then you are going to earn interest at the valuation rate to the next installment date. It's like you have this little bucket that you have to keep filled. You have to have your bucket full when you get to the next quarterly deposit or when the required installment due. Otherwise, you get an interest penalty.

When calculating these interest penalties, the amount due stays constant. The amount due is not going to be affected by the fact that you paid it late. The interest penalty is going into a different place. If you owe \$1,000 for your quarterly deposit, it's going to be \$1,000 on each one, it's not going to go up because you missed the last quarterly payment. You calculate your current-year amount on a beginning-of-the-year basis without including an estimate of any deposits being late for the year. For the penalty interest, of course, it's going to continue until the last day that you can make a deposit for the plan year. And so, for example, for a calendar-year 1995 plan, the penalty interest on charges is going to go all the way through September 15, 1996.

The liquidity shortfall is another new calculation, and it is a painful calculation to collect the information. How many of you have actually had a case that has liquidity shortfall. I've had some when actual calculations were required, not just estimated.

It's a lot of work to go through in a very short period of time because your calculation date and the first installment date are so close together. There are some other flaws in how this is calculated that could cause a plan to really cause a major cash crunch for the employer.

Again, it only applies to plans that have more than 100 participants or if the controlled group has more than 100 defined-benefit participants.

There are some penalties if you don't make your liquidity shortfall payment. First, there's an excise tax and if you don't have the deposit in by the 15th, then on the 16th, you have a 10% excise tax. There's no phase-in of that; it's just automatic. If you fail to make up a liquidity shortfall, that is, you might have it bounce around for different periods, but if you have a continuing liquidity shortfall for five quarters, the IRS can impose a penalty of 100%. This would certainly motivate most plan sponsors to try to get the money into the plan. It's going to do much more good there than it is going to do for the IRS.

The calculation date when you do your liquidity shortfall is the end of the quarter, but the installment due date is the 15th of that next month. If you have a liquidity shortfall at the end of the quarter, you only have the 15 days to get the amount in. In most situations, you can make an estimate. There's some leeway, but if you're really trying to fine-tune it, you would be in a very tight fix.

The quarters are based on months. So for a calendar year, January through March 31 is the first calculation period.

If a plan has a liquidity shortfall, then no lump-sum distributions or annuity purchases are allowed from the plan while that liquidity shortfall continues. You recalculate each quarter, and you do get to start over each time. So if you had a lump sum that was large enough to cause you trouble, but not big enough to get you over the special threshold and that drops out, then probably you aren't going to have any more trouble with the liquidity shortfall. Alternatively, if you have to put a deposit in to meet liquidity shortfall, you may not have a liquidity shortfall the next quarter.

On the first quarterly date, at the beginning of a new year, you have sort of a panic situation because the calculation period is so short. If, for example, you have a plan that is seriously underfunded, you may have a special break based on bringing the projected end-of-year valuation assets up to 100% of the current liability. That's all you have to contribute, but you have to have it in by April 15. There's no phase-in on that part of it. If it would occur on the end of the second quarter, you'd have to get the full amount in by July 15 for a calendar-year plan.

How do you do the calculation? The liquidity shortfall is the excess of the base amount over the liquid assets at the end of the previous quarter. The base amount is equal to three times the adjusted disbursements for the prior 12 months.

When you calculate your adjusted disbursements, you start out by looking at the payments that you have made for the prior year. The payments are all disbursements for annuity payments, for lump-sum payments, and for expenses. You adjust that amount by deducting your funded current liability percentage for the current plan year times the unitary payments. Basically these are the things that you'd look at as one-time amounts, lump sums, and annuity purchases.

There is a special exemption that is allowed, but it says that the Enrolled Actuary must certify, and there are no rules on how to certify. So if you would end up triggering this calculation, you probably would need to call the IRS and find out how it is that you would

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certify it. The IRS is looking for suggestions; it is asking for comments, so anything that we can send to it will be very helpful. When you do this, if you have a large lump-sum amount and you are allowed to use the *nonrecurring circumstances exemption*, then you can basically disregard that payment. In most cases this would help you with a fairly small plan that was hit by a large retirement in a particular year. It doesn't always come into play or help, even when you expect that some relief would be appropriate.

One of the things that this calculation is looking at is liquid assets. What are liquid assets? You need to look at Revenue Ruling 95-31, which defines it as cash plus marketable securities.

If you have insurance contracts, you have to be a little bit careful about how to use them. If they're essentially equivalent to a marketable security, then they can be considered to be liquid assets. They are also liquid if they're benefit-responsive. What about a contract such as an immediate participation guarantee (IPG) contract with a floor in which you have set aside part of the assets and it is reserved for your retirees? Then you can only recognize 36 months' worth of those payments by using the monthly income that's allocated to the participants. You then have to look at your assets as the assets minus the floor plus 36 months' worth of payments for the people who are in the floor.

The calculation on an underfunded plan gives you eight different periods. You have each quarterly date, then you have the due date for the next period. If you've met the liquidity shortfall requirement, you don't have to do anything until you get to the next testing date. When you are looking at your liquidity shortfall, for practical purposes you only need to look at what your total liquid assets are versus the base amount that you have to be covering. This occurs because when you add your contributions back in to see how much more you owe, it turns out that you subtracted them first but then you add them back in. So, the real question is, what's the net amount that you still owe? You're going to be in the same relative position based on whatever your total liquid assets are in the plan at that point.

One of the big problems that we face this year is that this is the first time we are going through this. We didn't have any chance to anticipate this so we could advise our clients last year about areas such as annuity purchases or better funding. If we could have adjusted retirement purchases, you could, particularly toward the end of the 1994 plan year, have affected your funded current liability percentage as well as any annuity purchases.

The IRS has not come out with information on exactly how to deal with this funded current liability percentage calculation. There is the implication that it will include any contributions that are made after that date, but there's no clear guide. You have to take the position, what would happen if the company didn't put any more money in? What would happen if your client ended up getting to September 15, for example, and it hadn't made the contribution that you thought it was going to make? You have to be very careful when you're looking at how to deal with that funded current liability percentage and what happens if your plan sponsor has not completed its contributions for last year. My advice on this is to not let it happen to you.

We've discussed a number of examples on how to go through the full-funding limits and the additional charges. One of the examples covers a case that ended up with a liquidity

shortfall even though we had done the valuation and the company originally had a credit balance that would have covered its entire minimum for the plan year. Then it had a first-quarter liquidity shortfall, so what in the world was that going to do to the calculation? One of the things that happens is that the required installments that you have to make for 89-92 are independent of the liquidity shortfall. So to the extent that you are making deposits to meet your normal required installment and you have deposited more than the amount that you would need for that, you would look at the little pot that I talked about. If you have to put extra money in because you have a liquidity shortfall, then your pot for purposes of required installments is full. You'll be able to use the extra for the next quarter's required installment, but you have to put the money in.

You could also have a plan in which the required installment that you still have due is bigger than the liquidity shortfall. Whichever one is larger is going to be the one that you can say is accumulating the extra interest. They both are running at the same time and when you make a contribution, you will reduce each one of them by that contribution just the way you normally would have been doing. So you can end up meeting your liquidity shortfall and still not have met your regular required installment or vice versa. The one thing to think about is that those penalty periods are for different lengths of time. When you get to the end of the quarter, with respect to the liquidity shortfall, then that's it for that quarter—you start all over again and you look at the new quarter and if you're lucky, you won't have any charge for the next quarter, but there will be two calculations that are going on simultaneously. At least we won't have to change the way that we're doing our calculation for the regular required installment. Those will still be there and you still need to do the same process that we've used in the past. It's going to be very difficult to get this new requirement to flow into our programs, to make sure that we're picking up all the pieces, and then to put this on the Schedule B.

MR. BARR: Which we haven't seen yet.

MS. JANZEN: That's right.

FROM THE FLOOR: I have one question. Is the liquidity shortfall on a controlled group basis or on a plan-by-plan basis?

MS. JANZEN: It's on a controlled group basis. You use the same rules that you use for the additional minimum calculation. My plan, which has had the most difficulty with liquidity shortfall, is in a controlled group. Each bargaining unit has its own deposit administration contract, and we have maybe 10-20 people in each one of these little plans. So when you have someone retire, it can throw you into a real problem. This should be a prime example of a case in which the nonrecurring circumstances would get you out of the problem, but it's not a guarantee. If you have had some small-amount payments on a regular basis or disability payments, the two-year test may not help. Or if you've had several people retire during the last three years, you can end up in a situation in which there is no relief, and yet the amount that you have to contribute is really ridiculous.

In this case you didn't have a chance to change your actions before they made the law change. The time framework that we've been dealing with in terms of this requirement, has been very, very short, and there has been so little guidance on what to do, which is a real problem.

MAINTAINING AMORTIZATION BASES AFTER FULL FUNDING

FROM THE FLOOR: What are current contributions?

MS. JANZEN: I didn't really go into that. Current contributions are contributions that are made during the current quarter to meet that next required installment. Other contributions are contributions that have been made either to meet the prior year's credit balance or a prior quarter's requirements. You disregard them when you're doing your calculation, but in fact they're in your assets. You disregard them as contributions, but it's not like they're not in your assets. When you look at your current contributions, you subtract those from liquid assets, but then you get to credit them toward the amount that you have due.

In the examples, the current contributions are contributions that are made to meet the current year's required installment, whereas the ones that are in a contribution credit balance line would be amounts that would be recognized as going toward the prior year's credit balance. But again, you don't actually get to recognize in your assets amounts that haven't been contributed yet. They will be in your funded current liability percentage to the extent that your plan sponsor actually makes them. So this is why you have the question, what do I do when I'm at that first date? Do I assume the plan sponsor is going to make them? What you need to do is tell the sponsor, if it's going to make that contribution, to get it in before the end of the quarter. At least then it will have made it and it will be there in its assets, and you'll be confident that it's there.

MR. BARR: You mean by March 31, not April 15.

MS. JANZEN: On March 31, not April 15. If it makes a late deposit between April 1 and April 15, the liquidity shortfall calculation can't count it until the next quarters's amount.

FROM THE FLOOR: What happens when you have been overfunded on a spread/gain method and you came out of overfunding? How do you set up your base?

MS. JANZEN: As long as what you're doing makes sense, the direction from the IRS has been to explain what you're doing on your Schedule B so that you've established what the method is. Preferably it would like to have this all spelled out before you are confronted with the situation, but there are different opinions on how to go through that.

MR. BARR: We weren't really trying to address that; we were merely trying to point out that when you do go to create a base, you need to take this full-funding credit and charge bases and reconciliation accounts, if they're greater than zero, as well as the credit balance into account. I do want to point out that this hunk of examples was constructed in such a way as to show that just minor changes from example to example in your valuation results will produce different patterns that come out of whether you have GATT full-funding charges present and so on. All different combinations of possible emerging realities are represented here with only slight changes in the valuation result causing those differences. Said differently, I think you'll be surprised at how easy it is in real life to get into these GATT full-funding charge situations. I've already seen a bunch of them in 1995 valuations. They just emerge.

