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Dialogue with the Pension Benefit Guaranty Corporation (PBGC)

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Summary: A panel of practitioners and a PBGC representative discuss current issues relating to the federal pension insurance program. A significant portion of this session is devoted to audience questions, with the objective of increasing your knowledge of the issues facing the PBGC.

Ms. Pamela Lash Marlin: Ellen Hennessey, deputy executive director and chief negotiator of the PBGC was previously a partner with the law firm of Wilke, Pharr and Gallagher. Ron Gebhardtsbauer is the senior pension fellow at the American Academy of Actuaries (AAA), a former chief actuary of the PBGC and former head the retirement practice of Mercer in New York. Ellen has a few opening remarks that she'd like to make and then she will introduce a couple of discussion items.

Ms. Ellen A. Hennessey: This session was advertised as one for people who didn't know the PBGC very well. We're going to talk about three broad topics, spending about equal time on each. First, we're going to talk about the PBGC premiums that you need to deal with every year for defined-benefit plans that we cover. Second, I'm going to talk about reportable events, which you only have to deal with

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episodically. Finally, I'm going to talk about plan termination, which hopefully you don't have to deal with very often.

PBGC PREMIUMS

Our premiums are split between the $19 participants' flat rate premium that all plans pay and the variable rate premium of $9 per $1,000 of underfunding that only underfunded plans pay. Starting in 1997, the variable rate premium will be uncapped. That means that the calculation of the unfunded vested benefits that you do for purposes of the PBGC premium calculation is certainly going to continue to be an important part of our premium revenue.

We have begun to audit all premiums. As a result of the audit, the AAA and the American Institute of Certified Public Accountants (AICPA) approached us about developing a procedure for the plan's own auditor to come in and audit the premiums, so that when the PBGC randomly selects your client for audit, there would be work papers to look at.

In the course of an audit, we start from the W-2s and we work our way forward to the number of plan participants. This work is typically done as part of the normal audit cycle in any given year. However, we ask for this information for the past five years. If this kind of reconciliation hasn't been done in the past, the information can be difficult to produce. It might not present a problem for a very simple company with very few people. However, for complex conglomerates that bear very little relation this year to the previous year or previous five years, it can be a real problem.

There is receptivity on the part of the employers, as well, to pay for their own auditors to audit the PBGC premiums. This procedure is going to be available on a voluntary basis. The incentive for the plan sponsors to follow this procedure is that the PBGC will only look at the auditor's work papers in the course of our audit. If the auditor has properly followed the procedure, we'll stop there. The plan sponsor won't have the risk of having their auditor sample participants who are different than the PBGC's. I'm working on this procedure on behalf of the Academy.

Mr. Ronald Gebhardtsbauer: We've had a couple of meetings with the PBGC. Some of the problems they found in their audits are that people are not being counted—mostly on the per participant count. Some plan sponsors weren't counting the retirees, and that was easy to catch. I don't think the variable rate premium side is being checked as thoroughly, but now that the cap is gone, that's where much of the premium money is coming from. We're talking amongst the actuaries and with the PBGC about how to make sure that the variable rate premium is also correct. Maybe there are ways to make the form easier to understand or the calculation easier to perform correctly. There are some questions as to what is in the vested current liability and what is not in there. In fact, we'll be putting those questions to the PBGC. The next question is, can the form be edited for clarity?

Another item under consideration is the voluntary disclosure of additional information on the variable premium. There will be an investment of time in order to give the PBGC more information in the calculation of the variable premiums. The return is a smaller chance of being audited or of a smaller audit performed. I don't know if you've seen the PBGC audit request letters, but I think they've been passed out, at least at the Enrolled Actuaries (EA) meeting. The request is pretty extensive.

The premium audit can be quite an extensive process so we're trying to figure out ways in which the information can be gathered each year as part of the regular plan audit. This way, you won't have to go back five or six years to find all of that information.

Ms. Hennessey: As Ron mentioned, one of the things that we're seeing a great deal of, even in the larger companies, which surprised me, is that the person filling out the premium form simply forgot the retirees. The prior administrator had been filling out the form correctly, and then, when that person left, the new administrator thought the word participant didn't include the retirees for some reason. As a result, the plan sponsor went two or three years without paying for the retirees and needed to pay a significant amount of penalties on top of the premiums and interest when they were audited.

Mr. Gebhardtsbauer: I have a study note that the SOA uses for people when they're taking their exams. This study note has a section on ways to minimize the premiums. I know some people at the PBGC have this study note, so I'm assuming most of these are legitimate, legal ways of reducing premiums. The study note doesn't tell people to skip the retirees, but, for example, if you buy an irrevocable commitment for your retirees, then you don't have to pay a premium.

Ms. Hennessey: If you think it's cheaper to pay an insurance company than to pay our $19, then that is clearly a legal way not to have to pay premiums. One thing you have to watch is that all benefits are paid from the insurance contract. Some companies have bought an irrevocable commitment and, as a result, they have not been paying premiums on their retirees. When they grant a cost-of-living increase that is in the plan but is not insured, the retirees become participants again unless the plan sponsor purchases an irrevocable commitment for the additional benefit. It isn't enough that you buy insurance for most of the benefits. If there's a benefit that is still being provided out of the assets of the plan rather than out of the insurance contract, then those retirees are participants and you must pay PBGC premiums for them.

Mr. Gebhardtsbauer: Or you might have an immediate participation guarantee contract where, if your assets don't perform well, the employer has to pay additional money to the insurance company. That's not an irrevocable contract, and you do have to pay premiums on those participants.

Ms. Hennessey: If you have never tried to cash out an immediate participation guarantee contract, trust me. I was involved in litigation on this, and I can tell you, it definitely is not a commitment.

Mr. Donald J. Segal: Let's pursue this a little while because this goes way back, probably into the 1970s. I thought the PBGC had said that under an immediate participant guarantee (IPG) contract, since the participant had a certificate from the insurance company guaranteeing the benefit, that was considered a guaranteed benefit, and therefore PBGC premiums did not have to be paid.

Ms. Hennessey: IPG contracts come in all flavors. Different people put different things on an IPG contract. Not all of them include the guarantees.

One other thing you should be aware of is that on December 16, 1996 we issued a notice on penalties in the premium area. People have been complaining for years that our penalties were too high. If you're late in making a premium payment, it's 5% a month. That's on top of the premium itself and interest. What we announced in December was that if you find the mistake and report it to us before we tell you we're going to audit you or before we tell you that you've made a mistake, the penalty will only be 1% a month. If we find you first, it will be 5%. That is a little bit of an incentive for you to review the premium calculation or advise your client to review the premium calculation as part of any ongoing compliance audit or on some sort of routine basis because now there really is an advantage to reporting it yourself.

We had an open window until April 1997 for premium mistakes that you've made with respect to prior years. You had to tell us by the end of April that you had made a mistake and that you will correct it by July so that the amnesty period can end. We reserved about one half million dollars just on those filings alone. And we haven't finished tallying. We looked at the big ones. Some sponsors that have to make a correction aren't paying until June 30, so we won't know what the total is until after June 30. This 1–5% policy is a permanent program for premiums due for 1997 and going forward.

Mr. Segal: I'll ask you another question as long as you want to stay on premiums. For short plan years, it says you have to pay the full premium and then apply to the PBGC for a refund, which sometimes takes years. Why can't we make the adjustment in the following year's premium?

Ms. Hennessey: It would be enough. I asked that question, and I have not gotten a satisfactory answer.

Mr. Segal: So what you're saying is that you're with us in terms of going to that simpler administration.

Ms. Hennessey: The rate is written that way. The short answer is the rate, for some bizarre reason, was written that you pay us and we pay you back. That seems a very inefficient system to me. A premium regulation project has been on our agenda of things to do some day when we don't have anything better to do. This kind of issue will be dealt with then, but it's just not been a high enough priority. Employers are not clamoring over that question.

Mr. Gebhardtsbauer: I think I remember some of the history on that. They wanted the premium regulation to be short and manageable so that you could read it quickly. They were afraid of getting into mergers and spin-offs and transfers and new plans and short plan years and telling you exactly what to do on each one because that would be another ten pages. They sort of left it blank in those areas and said that they would get to it in the next proposed premium regulation. In fact, I think there was a proposed premium regulation that suggested Don's idea, so that you can get a refund in the next year for new plans and also for short plan years.

Mr. James A. Hughes: A number of our clients have noticed they've been getting bills recently from the PBGC for interest and when estimated premiums were underpaid. In some cases, the interest had been offset against other amounts and that creates penalties because the plan's sponsor didn't realize there was going to be an offset. Are you aware of this program and can you speak to it?

Ms. Hennessey: I wasn't aware of the offset part of it. I'm aware that we generate an automatic bill in our premium system now that we've gotten it computerized and that there is interest running. If you don't pay enough in the estimated premium, the interest continues to run. I was not aware of the particular offset problem. There is now a designated premium problem resolution officer within the PBGC. The way to reach that person is identified on the premium form.

One of the things that has been helpful about this premium audit process is that a lot of things are being worked out where there are rules that are being administered in a way that's either inconsistent with the regulations or inconsistent with other statements that are made. In some cases it might be that the clarification may not end up in the way you would prefer, but at least you deserve to have it not be a secret. Other questions on premiums?

Mr. Gebhardtsbauer: Many companies are switching their asset valuation method from actuarial value of assets—sort of smoothing of assets—to market value because market value is going up so much. Much higher assets could reduce your premiums. Maybe I need to give a little history or background.

When you calculate your variable premium, you can calculate under a general method which means you calculate it on the last day of the prior year, say a calendar year, December 13, 1996. Or, you can calculate it using the alternative calculation method which means you go back to the beginning of that year and move it forward. There's more than one way to do the general method. You can actually do it based on the January 1, 1997 valuation and move it back one day to the last day of the prior year. What was happening is some people had switched to the market value method for their assets effective for 1997, but they used it for December 31, 1996. The same thing happened with assumptions. They were using the 1997 assumptions. It's very clear in the PBGCs instructions that if you use 1997's assumptions, when you go back one day, you have to switch back to the 1996 assumptions. It wasn't as clear on the asset valuation method. The PBGC made it very clear at the EA meeting that if, in 1996, your asset valuation method was sort of a smooth method, you must go back to that smooth method and, of course, that will increase your premium.

Ms. Carolyn E. Zimmerman: I'd like to follow up on the statement Ron made. This gets a bit technical and is on the subject of changing asset valuation methods. If you change from fair market to an averaging method with a phase-in (so that for my 1998 valuation I have a two-year phase-in where in 1997 I would have had one-year phase-in) is it necessary for 1998 premium calculations to go back and use a one-year phase-in because that happened to be where I was in the method in 1997?

Mr. Gebhardtsbauer: Yes, you have to go back. In the law, the calculation must be based on the last day of the prior plan year using all assumptions from the prior plan year. The exception is you have to use whatever the rules are for current liability. It's the 1983 Group Annuity Mortality (GAM) table now, and you have to use the interest rate specified in the law which is, I think, 85% of the 30-year Treasury. You do have to go back to the asset valuation method for the prior year.

Ms. Zimmerman: So it's not just when I change from one method to the other; it's actually where I am in the phase-in of that method.

Ms. Hennessey: I think the fundamental question is, is the asset value that you get on January 1, because of the change in methods, significantly different than the asset value that you would have gotten at December 31, 1996 if you hadn't changed the method?

Mr. Gebhardtsbauer: That's true. There are only material differences.

Ms. Hennessey: The question is really one of materiality. It's not mechanical, so you, as an actuary, can probably tell the answer to that question.

Mr. Gebhardtsbauer: If you've done an end-of-the-year valuation on December 31, which way would you have done it?

Ms. Zimmerman: It's really a question of, when will I consider that next year to be phased in?

Mr. Gebhardtsbauer: You can always pay a larger premium to the PBGC. If it gives you a larger premium, it doesn't matter if it's wrong. You can pay that.

Ms. Hennessey: Now if we discovered that in audit, we will force ourselves to pay you back. The odds that we would discover that particular error in audit would be low. I can't remember whether it ever happened.

REPORTABLE EVENTS

Let's discuss reportable events. We published a reportable events regulation in December 1996. It was effective January 1, 1997. If you have not looked at the new reportable events rules, I think you really need to because we revamped the reportable events in their entirety. We went back and looked at existing exemptions from reporting, and we updated them. In some cases, we actually increased the amount of reporting. Some situations that had been exempt before under the existing reportable events, are now reportable.

We also significantly reduced the reporting for well-funded plans across the board. A very significant area where we changed the rules had to do with minimum funding. The reportable events now apply to the annual minimum funding payments, which are not necessarily secured, to the funding deficiency in 412, and to the quarterly payment. This requirement was in the proposed regulation. We received no comments on it until a little bit before the EA meeting, at which point people said that their clients paid their quarterly contributions. One of the American Society of Pension Actuaries (ASPA) actuaries actually went online and gathered information from other actuaries about the extent to which their small clients were not paying the required quarterly contributions. He sent that to us on

May 6 and on May 8 we issued Technical Update 97-4, which grants relief on reporting the quarterlies for this year while we look at the question.

Basically, if you have a client who is not paying the quarterly contributions, including the January 15 quarterly that was due with respect to the prior year, then that client does not have to file a reportable event form with us every quarter. So if you didn't file in February for this January payment, your client is not delinquent. Plans for which the employer is not paying the quarterlies, if the plan is under 100 participants and only one filing is due, that filing will cover the January quarterly for last year and all the four quarters for 1997. That one filing is due at the same time as the PBGC premium was due, so the thinking was that the client in most cases would not be aware of the problem until the actuary came in to do the valuation sometime in the summer. The best time to make sure that the actuary had been in was at the time for filing the premiums and the Schedule B. One filing will suffice. We have a new form, and it is a very simple form. We will look at these filings and then someone will be bound to try to draft a permanent rule.

We also extended the same relief to slightly larger plans, plans that have 500 or fewer participants, or perhaps it is less than 500 participants. I always get the cusp wrong on these so go by whatever it says on the technical update.

If the plan was not required to give the notice to participants last year, then the plan was sufficiently well funded. They shouldn't have to give the participant notice. They also will be able to get the relief to have a one-time filing in September for calendar-year plans that will cover reporting on the January quarterly contribution and the April 1997 quarterly contribution. Please let me know the extent to which people have any other suggestions regarding what the permanent rule should be. Our concern is that we don't want to exempt reporting on quarterly contributions from plans that are not well funded and that pose a risk to us. We simply gave unfunded plans a blanket exception for this year so that we could get some information on the process. We don't want to construct a rule, particularly for the small plans, that's so complicated that it turns out to be more of a burden for them than paying the quarterly contributions.

Mr. William Ruschau: The relief for the small plans is nice, but I wonder, why bother? Why not simply say, if there are no quarterly contributions or payments outstanding at the time the premium is paid, don't bother to file the report for missing contributions or for the late payment. Why is the PBGC even concerned about amounts that are late but have since been paid before they make the filing?

Ms. Hennessey: The PBGC wanted the report on the quarterly payments because under the old system you waited until September of the following year to make your contributions. For 1997 you would not make your payments until September 1998. That's a very long time, and it can build up to a sufficiently large contribution amount relative to the size of the employer that it, alone, could become a trigger for bankruptcy. We don't want to unravel the quarterly contribution requirement. We want to know if people aren't making the quarterlies, especially if the plan is big enough that the failure to make the quarterlies would put us at risk.

Mr. Ruschau: You're talking about small plans and, at most, a one-year period.

Ms. Hennessey: We granted the relief for the 100-participant plans.

Mr. Ruschau: There's no relief in the filing, I guess. You still have to file, and it doesn't seem to serve any purpose.

Ms. Hennessey: You're filing this in September 1996. We were assuming that you still wouldn't pay the quarterlies for 1997 until September of the following year, so that we would be getting information kind of midway through the process to allow us to judge whether there was risk here. But this is a one-year relief. We will look at it. It's possible that we'll grant permanent relief on the 100-participant plans. We just thought that this hadn't been raised either in the negotiated rule making or in the comment period. I think we are going to issue a permanent rule of some sort dealing with certainly the under 100-participant plans and possibly the under-500 plans as we go forward.

We've also provided in the report of events, in a new voluntary form, the Form 10. One of the filings has the reportable event form. Does it have the instructions as well? You can go to my web site, www.PBGC. It's not terribly clever, but easy to remember. On the first page of the web site, the home page, there's a heading for reportable events. You'll get to the reportable event form. The full web site is mentioned in Technical Update 97-4, so if you want to go directly to reportable events, the directions are near the bottom.

This is a voluntary form. If you read the instructions, I think it will give you a good explanation of each of the reportable events. The front of the form lists the reportable events, and I found it to be a handy reference to remind me of what the reportable events are when I'm speaking. I think it might be useful for you as well. Most of the questions are answered.

Don asked me about the quarterly payments. What happens if you don't make the quarterly payment on time, but you've made the quarterly payment by the time you would otherwise have to report to us? In the spirit of the person who asked the question—we don't really want paper. We would much rather have you pay the premium and pay the minimum funding and not bother to send us the reportable events because, by then, it has been cured. What we said was that if you have paid by the time the reportable event filing would be due, then we waive the reporting requirement. You essentially have a 30-day extension.

The period is shorter for advance reporters. I think you have about ten days to notify us. Most people are not advance reporters, and I'm not going to talk about them unless somebody has a question about the advance reporting. There are only about two dozen companies, and I've talked to all their lawyers and their actuaries. If there are specific questions, I'll deal with them. I don't want to close that topic, but it's not of general interest to most people. Most of you don't have clients with more than $50 million underfunded that are privately held.

Let me focus a little bit on the reportable events themselves that are involved in corporate transactions because this is what we're dealing with in our early warning program. Our corporate financing and negotiations department handles this, and I get myself involved in it every once in a while. It's why I'm the chief negotiator. The chief negotiator negotiates. We are looking at generally corporate transactions. We have four new reportable events as a result of the Retirement Protection Act (RPA) in 1994. I'm going to start with the new reportable event that actually was an old reportable event—414(l) plan spinoffs. It’s not the corporate transaction itself, but the transfer from the seller's plan to the buyer's plan of a portion of the plan’s assets and liabilities.

Let me start out by saying we are all in agreement that you do not have to use the PBGC assumption to do the 414(l) calculation. It is a safe harbor under the IRS regulations. What we have done with the reportable event is to require that you report to us if you are splitting the assets on some basis other than the PBGC assumption. Obviously, you don't have to report to us if both plans are fully funded on assumption after you split the assets. Assuming one of the plans is not fully funded or both of the plans are not fully funded on your assumption, then you do have to report to us. This one is critical for actuaries because what you're going to have to explain to us is why you, as the actuary, think that the assumptions that you used were appropriate to reflect the cost to satisfy these liabilities on a termination basis. Section 414(l) requires that the participants have to be as well off after the transfer as they were before the transfer, assuming that the plan is a plan that has been terminated on each side.

Over the years I have worked with a number of actuaries. I actually have a great deal of fun doing deals, and I know how much squishiness there is in actuarial assumptions. I know how important it is to know which assumptions you're using. I’d say to clients in deals, "What's the deal on the pensions?" and they'd say, "Oh, we're getting them fully funded." I would ask, "On what basis? Are you getting them fully funded on a funding basis, or are you getting them fully funded on an accounting basis. If it's on an accounting basis, is it an accumulated benefit obligation (ABO) or projected benefit obligation (PBO)? Are you getting them fully funded on a PBGC termination basis?" Typical clients, in fact, typical lawyers can't answer those questions. You, however, are required to answer those questions because it's your certification that goes to the IRS, and we will be looking at that question. I think the example that you all know about is the very first case where we intervened. It was a situation in which basically the transaction occurred in December of one year and the actuary was using assumptions from the end of the prior year because basically the deal had been negotiated off of the prior year Financial Accounting Standard Board (FASB) numbers. The deal was that they were transferring the projected benefit obligation plus a cushion. Even though the assumptions were different than our assumptions, until you run the numbers, you don't know how it compares. The result was that the plan before the transaction was $30 million overfunded and after the transaction, one of the plans would have been $20 million underfunded. That was a fairly big swing on a PBGC basis.

We had long discussions before we talked to the client. My actuaries talked to the actuary who had done the transfer about why we thought that these assumptions were correct. Because it was the first case in which we had intervened, people weren't prepared for the question. They ended up settling to restructure on the safe-harbor basis because we were so close to the closing dates. Subsequently, because people are now aware of the issue, people have been coming in to talk to us about larger cases, particularly about assumptions that the actuaries use as reasonable on a termination basis. We have in fact given no action letters in situations where the transfer was not on our assumptions. We cannot tell you that the assumptions you use are correct because the interpretative jurisdiction belongs to the IRS. All we're saying is that we will take no action. Given the number of 414(l) cases that have been brought in by the IRS, I think people are fairly comfortable that if we don't take action, nobody is going to take action.

Mr. Gebhardtsbauer: Some actuaries that I've talked to think that maybe their assumptions are better than the PBGC safe harbor assumptions, but they're a little bit nervous about using the new assumptions. There might be a way to talk to the PBGC or find out what the PBGC might do. Does the PBGC have some sort of guidelines or can we get a feeling for what you can go for? Is there a process?

Ms. Hennessey: I think it's too early to tell right now. Most of this comes up in the cases that corporate finance and negotiations handles and those are situations in which the underfunding of the plan is more than $25 million or there are more than 5,000 participants. Karen Krist and Kevin Minor have both been involved in this so they are good actuaries to talk to. I personally did not advance any view at all on any assumption. I was taught, long ago, by very good actuaries, that whatever I thought I knew based on the last plan I looked at, was wrong. PBGC assumptions were good for my client in one deal, and they were bad in the next deal. I think it's really a question of whether you actually go out and buy annuities.

We have a proposed regulation out. The comment period closed recently. Suffice it to say that we're not ready to issue the regulation yet so, in a sense, people want to comment, but we're not going to not read the comments. We got about half a dozen comments in over the last couple of months and we will be looking at redoing our assumptions. I don't think you should expect that our assumptions will deviate from the principle that underlies our assumptions, which is that the cost (the method for allocating assets among the various participant groups) should be near private sector annuities (group annuities on a terminating plan basis). However, people have always complained that our assumptions overstate the liability. This is the opportunity to come in and show us that is not the case. If you have purchases of annuities where the result was significantly different—or wasn't significantly different—from our assumptions, then we would be happy to get that evidence in the record because this is quite sincerely an effort to look at whether we can have a better process for assumptions that more clearly mirrors the market.

Mr. Gebhardtsbauer: The Academy is also doing a study right now on that very issue. If you have a situation that you would like us to look over where you did the calculation from the PBGC basis and you have the quote from the insurance company, send it in to us. We'd like to see it. If you don't have the PBGC quote, you can give us the data, and we'll figure out what the PBGC calculation would have been and do the comparison. We'd like to do that. There has been a quick study just to see if there are anomalies and where the anomalies occur. Is it because of an early pattern assumption or is it because of interest assumptions? In the future, we're maybe going to do a bigger study to get into that further. If you have something like that, please send it into the AAA.

Mr. Segal: I think a number of companies have been contacted. If your company hasn't been contacted, and you have data on a plan termination where annuities were purchased, that's one of the magic cases. If you could send the data in to the Academy, I guess Ron will be able to route it to the task force with the quote, which is most important. Even if the results show that the PBGC number is right on target, we want to know that too. This is intended to be an objective scientific examination.

Ms. Hennessey: To keep it objectively scientific, we've also been talking to the pricing actuaries at the major insurance carriers that deal in termination annuities.

We're finding that our whole assumption set taken together does not differ significantly from the actual purchases. It is an average, obviously, because it's in the middle between the high and the low. What was interesting is that we are finding that the highest cost annuities are with the company that owns about 25% of the market. What that suggests is a flight to quality.

Mr. Segal: With regard to these 414(l) calculations and the safe harbor being the PBGC assumptions, does that include the use of the expected retirement age (XRA)?

Ms. Hennessey: Yes, that's clearly the case with the safe harbor. One of the things that's clear and we're going to be looking at when we do the regulations is the calculation was written to look at guaranteed benefits. Because it was designed for plans that we have taken over during the period when we didn't take plans over unless they didn't have enough assets to meet guaranteed benefits. The regulation focuses on guaranteed benefits, which are a subset of nonforfeitable benefits. It does not deal with category six benefits, which are the forfeitable benefits, and the benefits that aren't pension benefits. One of the things we're going to be looking at is putting something in the regulation. We don't know how general or how detailed we should be in indicating that category six benefits are different.

Mr. Gebhardtsbauer: Actually the PBGC's XRA is probably undervaluing the subsidies in contingent benefits.

Ms. Hennessey: I think that is actually a fruitful area for discussion in terms of situations in which you don't think it's appropriate to use our XRAs to value the benefit liabilities.

Mr. Segal: Because the XRAs are one of the most difficult, the effort versus the value is disproportionate in terms of using XRAs as opposed to let's say the actuaries' own retirement age assumption for purposes of the valuation. We're required, you might say, by statute, by revenue rulings, and so on, to have a retirement age that is appropriate that recognizes the terms of the plan and the experience.

Ms. Hennessey: We have unfortunately seen actuaries who assumed a retirement age of 62 when the average age of the retirees was 60. I think we're clearly in agreement that to the extent that you could actually go out and purchase these annuities at a different rate that would be okay. The question is what would the insurance company do about the expected retirement age? Some of that depends on what kind of company is sponsoring the plan and whether you would expect some dramatic shutdown of operations, for example. We're finding, and this was a surprise to me, that plans that have lump sums in them are more likely to have extra pressures.

From the Floor: Deal with lump sums. It has been my experience that if I want to terminate a plan and get out cheaply, I might offer lump sums.

Ms. Hennessey: That's interesting. If you want to terminate a plan that has lump sums and you want to buy annuities that include the lump sums, it turns out that you end up with actual annuities that are slightly more expensive. One thing insurance companies pay is the risk.

Mr. Gebhardtsbauer: Using the tables and assumptions required by GATT, lump sums can be less than the present value of the annuities.

Ms. Hennessey: That strategy is coming up. We would like more evidence on that question about the incidence in which the retired or the not retired population takes a lump sum. That is clearly the type of question that we're going to have to address with the IRS.

Mr. Segal: If you have a lump sum in a plan you are terminating, my experience has been that you can count on 90% of the people taking the lump sum regardless of what they're giving up in subsidies.

Ms. Hennessey: That's a higher percentage than people have argued about.

Mr. Segal: Ninety five would be my lowest estimate.

Mr. Gebhardtsbauer: One of the things that Ellen brought up was the possibility of going to new valuation regulations. A new valuation regulation would initially be meant for their own internal valuations for distress terminations. Because 414(l) references as a safe harbor, it would affect corporate transactions, spin-offs, and that kind of thing. One of the suggestions is that they would go to the 1994 table which is generational. I guess the people who put that table together thought it was very important to project mortality. I think we, as actuaries, would all agree with projecting mortality. Could I have a show of hands on how many firms can do generational calculation? Maybe I need to specify what I mean. Generational mortality is a matrix of QXs, not just a vector. As such, it's a function of your age and what calendar year you're using. Doing generational mortality would mean many of the firms would have to change their valuation systems. I did it one day at my home, and I just did a spreadsheet. Of course, it wouldn't handle joint and survivorship or C&C or nonlevel benefits or anything like that. I am wondering whose firms have the ability to do a generational mortality table now.

Ms. Hennessey: Are you all with a single firm?

From the Floor: It's not the standard system.

From the Floor: Determining how many people in fact have systems that can handle it is another question.

Ms. Hennessey: We're assuming that not everybody can do it. I think we're looking at some sort of a table, but our thinking is that we're leaning towards a process by which the table is being updated periodically.

From the Floor: Perhaps it's a static table that would be updated.

Ms. Hennessey: Let's assume that we went to an annual update. There would be a table for 1997, a table for 1998, and a table for 1999.

Mr. Gebhardtsbauer: The 1994 Group Annuity Reserving (GAR) table says that you project ahead nine years. You get almost the same answer, but that, of course, depends on your group. If the plan is mostly retirees, you only have to project it five or six years, but if you have a very young group, maybe you should project ten or 15 years.

Ms. Hennessey: We have people who study these tables more than I do. One of the things I was told was that the GAM 83 projection Scale H actually overestimated the improvement of life expectancy among women and 1994 is less robust on future mortality increases.

We have the authority to impose $1,000-a-day penalties. In the policy we issued on July 18, 1995, we are not getting 100% of that. We normally will not impose $1,000-a-day penalties for routine failure to file things on a timely basis, like reportable events or your premium filing to the extent the information stuff is not there. The rule for most reportable events, is it's $25 a day for the first 90 days and $50 a day after 90 days or later. We prorate for plans under 100 participants. There's a cap at 100 participants. If you have questions about those, don't ask me. I don't go under 100 participants. However, there are notable exceptions. The $1,000-a-day penalty will be imposed and has been imposed, for failure to file advanced reportable events or to file the Form 200, which is the form you file if you miss more than a million dollars worth of minimum funding in either your quarterly or annual payment. Those are two situations in which your filing is the only way in which we know we have to do something. We also reserve the authority to impose up to the full $1,000 a day where we find willful violations or a pattern of violations or significant harm to us or to the participant. I think those are the exceptions in the other reportable events.

One of the reportable events that was an old reportable event was a 20% reduction of active participants. You could do that on a controlled-group basis aggregating all the plans. Now we're going back to looking at each plan so that's a significant change. The reason for that is we have refocused on Section 4062(e) and we are in the midst of developing a proposed regulation. This is the one that says that the provision has been there since the Employee Retirement Income Security Act of 1974, although it moved around a couple of times. It says that if you see separations at a facility and, as a result, more than 20% of the participants separate from employment, you have to post a bond with us or make a contribution to the plan. We are actively enforcing that.

One of the first questions that came up, which we have an answer for, is if you sell an asset like a factory, and the employees go to work for the buyer, is that a cessation of operation? The answer is yes. We are in negotiations with people about the amount of the buy. It is a very awkward provision because it's 4062 and it takes you to 4063 of ERISA which discusses how you allocate liabilities among multiple employer plans. We're going to try and have some fairly straightforward rules so we can understand how those provisions work together in 4062. I would expect to see a proposed regulation in the summer of 1997. I'm not going to say whether it will be early summer or late summer.

PLAN TERMINATIONS

You might find it interesting that we have a regulation out on the standard termination. There is a proposed regulation that's already out. I think the comment period is coming up soon. We have heard many complaints from people, including actuaries. We did a bunch of focus groups because this has been a constant source of friction. The time deadlines were causing people problems, and if you miss by a day or two days, your whole filing was undone. We've proposed rules that would extend those time periods, and explain when the standard will and will not undo the information.

There are differences between the existing rules and the proposed rules. The general comments we've received have been favorable, but if you still see problems, please let us know. We haven't yet written the final regulation, so comments in the next week or so would certainly be well received.

Since 1987, we have been required to do a standard termination audit. The most common mistake that we're finding is people are using the wrong interest rate for lump sums or people are using some rate other than the rate in 417(e) of the

Internal Revenue Code (IRC). The correct answer is you must use the IRC interest rate. Obviously you can switch to the GATT lump sum. An important thing you should know, that is particularly important to GATT lump sums, is it has always been the PBGC's position going back to the oldest case I know of that you cannot make amendments to the plan after the plan terminates unless they are favorable to the participants. You can always make an amendment to give away the surplus. You can make amendments that are required to keep the plan qualified, but if there are two ways to keep the plan qualified and one cuts benefits and one increases benefits, you must use the one that increases benefits. This is something we pick up occasionally on audit, and we made it especially clear in the proposed regulation.

We also indicated that we are going to stop referring over the names of annuity providers based on some mysterious formula that we have. We're going to send to the Department of Labor (DOL) the names of all the annuity carriers, but I think you should be concerned when we come in and audit. One of the things that we will be looking at is the quality of the annuity carrier from whom the annuity is purchased and that will be the primary enforcement mechanism. Worrying about people that you could have bought annuities from but didn't doesn't seem a productive use of anybody's energy.

One of the things that the government accounting office has been after us for, and that showed up on our annual audit that we hadn't done anything about, was to require terminating plans to give information to the participants about the state guarantee fund. We issued a proposed regulation saying that you had to give them a little blurb we worked out with the National Association of State Guarantee Funds and a listing of the state guarantee funds and their addresses and telephone numbers. That is probably the single most commented on feature. People are saying it's a waste of paper, so I believe we'll be looking at that. It's an area where you'll see some reduction in the number of trees that are killed.

Mr. Gebhardtsbauer: One of the things that was mentioned at the Academy meeting was that you have to give a notice to your employees of what insurance company you're going to use in the standard termination. You have to give it to all the participants—at least those who have a benefit over $3,500. Even if they've already elected the lump sum, you still have to tell them what insurance company you were planning on using for the people who haven't elected lump sums. The purpose behind that was so someone who elected to take a lump sum can change his or her mind or reduce the lump sum payment when he or she finds out there will be another company involved.

Ms. Hennessey: The other area we devote a great deal of time to at the PBGC is distress terminations. How many of you have been involved in distress terminations? We have a fair number of people. Obviously the new valuation regulations will make a difference. We actually have been looking at the PBGC. We discovered that more than half of our liabilities relate to just ten companies—most of them bankruptcies. If they weren't really bankruptcies, they were something that was so similar that they were indistinguishable. There was no judge. It indicates why it has been historically so difficult to price PBGC insurance. It also underscores the importance of our continued monitoring of financially troubled companies with large amounts of underfunding.

When looking at the claims history, we discovered that most companies that go into bankruptcy with a defined-benefit plan are not underfunded like the rest of the universe of defined-benefit plans. Of those that are underfunded, less than half terminate. That was an interesting discovery. We're spending a great deal of time on bankruptcies now by serving on creditor's committees.

It has turned out to be useful in one interesting way that I had not anticipated and that is, bankruptcy attorneys now take us much more seriously because, as members of the creditor's committee, we vote on the creditor's committee counsel. I found that to be an interesting development in terms of our being perceived as a real creditor as opposed to a fictitious government agency kind of creditor.

The other development in that area was the *PF&I* case that was handed down by the Supreme Court earlier in 1996. Sometime in the last year, the court held that the excise tax of minimum funding was not a tax for purposes of bankruptcy. There has recently been a decision handed down by one of the circuits holding that the excise tax for the reversion tax is a tax because it's a compensatory payment—payment to the government to compensate the government for the tax loss from the inside buildup in the plan. That's an interesting development.

We had supported the government in terms of arguing that the excise tax was an excise tax, which I didn't think was a novel proposition, but somehow the justices did. We had argued that the court should adopt the standards that it ultimately did, which was that you look at the nature of the government claim to determine whether it's a tax. The PBGC has always based its own claims, the tax priority, on the case that the Supreme Court relied on, *New York* vs. *Furry*. It held that the PBGC's claim is a government exaction to compensate for the insurance coverage that we provide. So it will be interesting to see whether that increases our elected rate of recovery in cases going forward. I can only guarantee that in bankruptcies you guys will continue to have business as long as these issues are not resolved by the Supreme Court. I hope to see some or all of you there.

Mr. Michael I. Wiesner: To what degree have you considered making the premiums paid a function of a company's financial condition?

Ms. Hennessey: That has clearly been raised often over these last 22 years. As you know, we didn't have a variable rate premium until 1987. In 1994, when we were working on the Retirement Protection Act (RPA), we looked at that question. The honest truth is that is a very bad measure of risk for the following reasons. We have difficulty predicting today who will be the plan sponsor in the future, it will be much less at the time the plan terminates. There are plans that were maintained by very healthy companies that we've taken where the healthy company sold the division off. We've been in litigation on an evasion theory, but certainly there are cases that we haven't brought, where we haven't had grounds for evasion complaints where that happened, such as in a case where some company sells off an unprofitable operation with an underfunded plan. A few years later, we take a hit. Imposing an additional premium on the companies that are underfunded probably only serves to exacerbate the problem. These companies are not in a position to improve the funded status of the plan. So the extra premium, while it is a correct function from an insurance point of view, might impose a greater risk. The fact is the insurance is not voluntary on their part or on our part, and the system tends to focus people's attention, both the premiums and the early warning program, on funding plans at points where they have money to fund the plan.

Mr. Gebhardtsbauer: The most important point is not to give more money to the PBGC. It is a way of encouraging plan sponsors to put more money in the plan so they don't have to pay the variable premium.

Ms. Hennessey: If we reached the point where there is no variable premium to be paid, I would be ecstatic. I don't think we'll ever quite get to that point, but we'll certainly move in that direction. It's not so much the premium—interestingly it was the notice to participants that generated significant contributions in 1996. In the first year that the notice to participants had to go to participants in plans that were less than 90% funded, more than half a billion dollars was put into plans by companies that did it expressly for the reason that they didn't want to tell a participant that they are less than 90% funded.

Mr. Gebhardtsbauer: A client at the company where I used to worked wanted to avoid reporting their financial and actuarial information to the PBGC. I think the unfunded liability has to be over $50 million for the required reporting to apply, so they got it under that, so they didn't have to report. Are there ways to get out of doing that and reporting to the PBGC or to get out of doing a notice?

Ms. Hennessey: You described the way you get out of it. You put in enough money to get your underfunding down below the threshold. It's either 90% funded or less than $50 million.

Mr. Gebhardtsbauer: How about the security?

Ms. Hennessey: We've occasionally discussed security as a way to get out of reporting. I can't remember if we've ever actually done it. I know we've talked about it. There may be one company that we did it with, but it also involved a significant amount of contributions. The other thing that you should know about is the reportable event following the annual filings that are exempt from the Freedom of Information Act. They are not publicly disclosable and that has made people more forthcoming.

We're also learning a great deal from these large companies that are now required to file. They are teaching us about the relationship between the funding assumptions and the PBGC assumptions. A good varying of filing includes valuing their liabilities on a PBGC basis; that is helpful to us, and it will be helpful to us.

The discussion on those calculations has been helpful along the lines of the questions that were raised earlier about 414(l), in terms of focusing our attention on obscure questions. It really has never come up in the case of terminating plans in the distress termination category because if there was enough money to go into category six (the forfeitable or nonpension benefits) we would all be ecstatic. There hasn't been a great deal of thought given by the PBGC to particular liabilities where the contingency has not yet occurred. We will be looking at that area and if people have questions, we would like to hear them.

I mentioned Karen Krist and Kevin Minor who worked on our early warning program at corporate finance, and Dave Gustafson and Jane Pacelli who work in our corporate policy and research shop. They are all working on the valuation so we really want to encourage people to participate and to give us their comments and to raise questions. If you have comments about how to value benefits using PBGC assumptions, we may not be able to answer all of them, but at least it will help us. We were going to try to answer those that we had the answers for. At least we'll be able to identify where there's a problem. We found, for the negotiated role making on the reportable events with lots of funds, we didn't anticipate the problems and that practitioners like yourselves were best able to tell us what the problems were. You're actually crunching the math and so it's helpful if you can describe it in a way that a lawyer can understand. If you can't, it's best expressed in symbols and then our actuaries will try and translate it.

From the Floor: I have some clients who have to do the $50 million unfunded filing as well as the top 50 list and so we are doing three different sets of funded status calculations, and three different assumptions bases for them. Any way you could collapse that into one so that they could use their consulting dollars for added value services rather than reporting purposes.

Ms. Hennessey: We've already told people that if they're doing the actual PBGC calculation, they can always use the actual PBGC calculation and give us information on that basis. We've never imposed that on people because it's pretty much a rough cut. We do a rough translation off the Financial Accounting Standards Board (FASB) numbers to get there, but I think the one that you can use is the actual PBGC calculation. People don't want to use their actual PBGC number, however, because the actual PBGC number is higher than what you get on our rough cut. They may expend the dollars just to have a lower number show.

Mr. Gebhardtsbauer: By the way since you brought it up, I think Ellen already mentioned that if you're over $50 million in underfunding, you have to report that, and that's confidential so I'm assuming that they can't even give it to the top 50 people.

Ms. Hennessey: Right, we cannot.

Mr. Gebhardtsbauer: So if you wonder why the top 50 people are asking the same question, it is because that other information is confidential.

Ms. Hennessey: Unless the client agrees that information can be used for the top 50, it won't be used, but that's a client's decision. The client can always choose to have it.

From the Floor: Another question on the PBGC top 50 is do you specifically ask for nonqualified information and do they explicitly exclude it? Explain what the rationale was for that and why you would ask for such information if it's excluded in the very end.

Ms. Hennessey: We're starting from the fantasy number so we're trying to work backwards from the fantasy number—it's a legacy of the policy. Most employers don't want to give us actual numbers for most of their plans. They want to back the foreign and the nonqualified plans out of their fantasy numbers. The policy has really been designed to accommodate that desire on the part of the client.

Mr. Richard Joss: I believe the PBGC charter says that one of your challenges is to foster the growth and development of defined-benefit plans.

Ms. Hennessey: I think that's a very important part of our turf.

Mr. Gebhardtsbauer: Could be on the IRS's too I think.

Mr. Joss: Could you enlighten us as to what's on your schedule to help move that process along?

Ms. Hennessey: We are inviting people to come in on the assumptions. Within the administration we are a voice for the defined-benefit plan. We sat for administration support for the repeal of 415(e) for example because we sort of had a deleterious effect on the defined-benefit side of things. We keep saying we're going to win every battle but we really think, shocking as it is, that defined-benefit plans are good things. That has not always been the case with the PBGC. I personally think we're not going to have adequate retirement income without defined-benefit plans going into the next century, so we're trying to foster them. Having said that, we are still insurance companies and we want to foster safe defined-benefit plans (I don't mean safe with all caps, which is a proposal from the American Society of Pension Actuaries, but safe in the sense of funded plans).

Mr. Gebhardtsbauer: There are some ideas on the Hill right now for eliminating the cap on the full-funding limit, and possibly allowing plans with less than 100 people to contribute up to the unfunded current liability or maybe even up to the unfunded termination liability. I don't know how much I'm allowed to say.

Ms. Hennessey: You can talk about anything, keep going.

Mr. Gebhardtsbauer: What about you guys?

Ms. Hennessey: You can't talk about us. We don't have an administration position yet.

Mr. Gebhardtsbauer: I know, but these things would help the PBGC, of course, because they would allow for better funded plans, and upon termination, they will allow you to not to have to pay the excise tax and be able to deduct everything you do in order to get the plan well funded. These are things that the PBGC probably would like to do.

Ms. Hennessey: As you might expect, it's an institutional tangent. I get annoyed at it but I don't think it's necessarily a bad thing. There has been a healthy friction between the Treasury, which wants to protect the federal budget and the PBGC, which wants to get plans as well funded as it possibly can.

From the Floor: I'd like to say I really appreciate the direction the PBGC has been going recently as far as looking at some of these rules. I can personally say my dealings with them have been much more positive in the last 18 months. I haven't really had bad dealings, but they're much more responsive.

I think four out of the last five terminations where I've been the enrolled actuary have been audited. I know that there's a statement that there will be a substantial number of plans audited, but 80% is fairly substantial. I was just wondering whether there was any criteria beyond randomness?

Ms. Hennessey: I don't know the answer to that.

Mr. Gebhardtsbauer: I think 5% or 10% plans were audited, if anybody complained to the Department of Labor or PBGC that those plans would usually automatically be audited, but beyond that I don't know if they have your name somewhere.

Ms. Hennessey: We don't, so I think you may just have been unlucky. You can tell me what the probability was that you turn up if we gave you all the facts.

Mr. Ruschau: I have a policy question but I don't know whether you're in position to answer or not. All of our clients have seen premiums skyrocket over the last ten years, and we have seen the abomination called the RPA funding rules which are efforts to develop solvency for the PBGC. I was just wondering if there has ever been any thought to simply increasing the PBGC status in bankruptcy situations to help the general creditors.

Ms. Hennessey: We gave a great deal of thought to that. Congress thought about doing that when preparing ERISA. The Bankruptcy Code changes made in 1978 have cast some doubt on that. There was a proposal right before the amendments were submitted for the bankruptcy code that passed in 1994. We made a decision, we were focused on the RPA, what with the banks and the unions and the large employers irate against us, it was unlikely that was going to pass. A different proposal might have some possibility, but I don't think anything will happen in bankruptcy until after the Bankruptcy Commission report is out in October 1997. I think there will be another bankruptcy deal. It's hard to say whether it deals with any of our issues. We've made some presentations to the Bankruptcy Commission but I don't anticipate that they're going to deal with our issues very much.