Pension Benefit Guaranty Corporation

85-9

April 5, 1985

REFERENCE:
4044(d) Allocation of Assets. Distribution of Residual Assets
4044(d)(2) Allocation of Assets. Distribution of Residual Assets Attributable to Employee Contributions
29 CFR 2617 Determination of Plan Sufficiency & Termination of Sufficient Plans

OPINION:

This responds to your request for the PBGC's opinion concerning the use of a "participating" annuity contract issued by an insurance carrier to satisfy all accrued benefits in connection with a termination/reestablishment transaction of the * * * Plan (the "Plan").

The facts, as we understand them, are essentially as follows: * * * Company (the "Company") has terminated a defined benefit plan, which has assets * * * substantially in excess of the present value of benefits. The Company will establish a new plan; however, accrued benefits under the old plan to the date of termination will be vested and annuitized, as provided by the joint Implementation Guidelines on asset reversions issued on May 23, 1984, by the PBGC, the Department of Labor, and the Treasury Department ("the Guidelines"). Residual assets will revert to the Company as provided in PBGC's Allocation of Assets Regulation, 29 C.F.R. § 2618.30 [*2] except for residual assets attributable to employee contributions, if any, which will be determined and allocated among the pool of eligible participants and beneficiaries in accordance with Section 4044(d)(2) of ERISA and 29 C.F.R. § § 2618.31 and 2618.32.

The plan administrator proposes to annuitize benefits by the purchase of a participating group annuity contract (the "Annuity Contract") from an insurance company in consideration of the payment of a one-time premium. For the reasons described below, the premium would be higher than that for a traditional nonparticipating group annuity contract, but expected return to the contractholder over the life of the participating group annuity contract may make it less expensive in the long run than the traditional group annuity contract.

All accrued benefits as of the termination date will be guaranteed under the Annuity Contract as the unconditional, irrevocable and non-cancellable obligation of the insurance company. In no event, including favorable or unfavorable investment or actuarial experience, can the amounts payable to participants under the Annuity Contract increase or decrease. The Annuity Contract will provide for all optional [*3] forms of benefit payments available under the Plan, including early retirement subsidies, preretirement survivor annuities and other benefits protected by the Retirement Equity Act of 1984. If there is a failure by the insurance company to make benefit payments at the time or in the manner set forth in the Plan and the Annuity Contract, you represent that affected former Plan participants would have a cause of action against the insurance company to enforce the payment of benefits.

The Annuity Contract differs considerably from the annuity arrangement typically used to close out a terminated plan. Under a typical nonparticipating annuity, the insurance company receives a single premium payment, assumes the obligation to make all benefit payments under the terminated plan, and bears all the risk and enjoys all the benefits of investment and actuarial experience under the arrangement. Under the Annuity Contract, in contrast, an ongoing relationship is created between the contractholder and the insurance company. The premium for the Annuity Contract is more than the cost of the nonparticipating annuity. In return for the payment of the additional premium, the contractholder is [*4] entitled to share in any favorable experience under the Annuity Contract, either investment gains or favorable actuarial experience (e.g., higher than expected mortality or lower than expected usage of subsidized early retirement benefits) based on a predetermined formula. The contrachtholder's participation rights work basically as follows: The assets underlying the Annuity Contract will be held in a single customer separate account of the insurance company. Each year during the life of the Annuity Contract the insurance company will pay a dividend to the contractholder equal to the excess of the value of the assets of the separate account over the insurance company's statutory reserves under the separate account for its liabilities under the Annuity Contract.

Initially, the trustee for the Plan will be the contractholder. The trustee was directed to purchase the Annuity Contract by the Investment Committee, pursuant to powers reserved to the Investment Committee in the governing trust document. This initial premium payment will be the only payment required for the Annuity Contract. After annuity certificates are distributed to participants upon the plan administrator's [*5] receipt of a Notice of Sufficiency from the PBGC, the trustee will distribute to the Company the remaining trust assets. These trust assets will include the Annuity Contract. Neither the Trustee nor the Company (after the distribution of the Annuity Contract) will make any further payments to the insurance company, unless a material error is discovered in the data supplied to the insurance company for purposes of submitting ths initial did. Any minor error that may be found will simply be adjusted through the dividend feature of the Annuity Contract.

As indicated above, the initial cost of purchasing participating group annuity contracts is greater than the cost of purchasing nonparticipating group annuity contracts providing identical benefits. In order to prevent overvaluation of benefits which could result in less than maximum benefits for plan participants when assets are allocated under Section 4044 of ERISA, the PBGC's regulation on Determination of Plan Sufficiency and Termination of Sufficient Plans at 29 C.F.R. § 2617.14(b)(1)(ii) requires a terminated sufficient plan to value annuity benefits through bids based on "single premium nonparticipating annuities that are non-surrenderable." [*6] Then, upon receipt of a Notice of Sufficiency from the PBGC, the plan administrator would ordinarily close out the plan by purchasing such nonparticipating annuity contract. Where there are residual assets, that is assets in excess of those required to satisfy all benefits under the plan when valued under § 2617.14(b)(1), those assets would then be allocated in accordance with Subpart C of 29 C.F.R. 2618. However, where, as in your case, plan assets are sufficient to purchase all benefits under either a participating or a nonparticipating type of annuity contract, the purchase of a participating group annuity contract does not adversely affect any participant's benefits as long as residual assets to be distributed to employees pursuant to Section 4044(d)(2) of ERISA are not diminished, i.e. the additional premium paid for such contract is derived solely from the Company's share of residual assets. In such a case, the regulations are not violated by purchase of the participating contract.

Finally, when a plan is terminated in a so-called termination/reestablishment transaction, all accrued benefits must be provided for by the purchase of annuity contracts that represent [*7] an irrevocable commitment for the benefit of each individual participant. This irrevocable commitment must be properly evidenced in the form of a certificate which is issued by the insurance company to each participant entitled to a benefit. The PBGC believes that the nature of this certificate and the related disclosures is especially important in a situation where the sponsor may benefit from future experience in the form of a participating annuity arrangement. In this regard, we have reviewed the form of the insurance company's certificate proposed to be issued to individual participants (Exhibit A enclosed), and in our view this form complies with these requirements.

Under the circumstances described above, it is the PBGC's opinion that the purchase of participating group annuity contracts in satisfaction of all accrued benefits in connection with the above-described termination/reestablishment transaction is permissible under Title IV of ERISA.

The conclusions set forth in this letter are limited to Title IV of ERISA only. Any opinions as to the acceptability of this type of arrangement under Title I of ERISA and the Internal Revenue Code must be obtained from the Department [*8] of Labor and the Internal Revenue Service, respectively.

I hope this is of assistance. If you have further questions concerning this matter, please contact * * * of my staff at the above address or at (202) 254-4873.

Mitchell L. Strickler
Deputy General Counsel