

Pension Benefit Guaranty Corporation

79-8

April 25, 1979

REFERENCE:

4022 Benefits Guaranteed

4044(a)(3) Allocation of Assets. Benefits Payable as an Annuity for Three Years Prior to Termination

OPINION:

This is a further response to your recent, separate requests for a Pension Benefit Guaranty Corporation ("PBGC") opinion regarding Section 4044(a)(3) of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1344(a)(3). On March 23, 1979, PBGC wrote to you concerning the application of Section 4044(a)(3) ("Category 3") to two specific plan provisions.

A Category 3 benefit is determined for a participant in a two-step analysis. First, a participant's eligibility for a Category 3 benefit would be determined, and then the amount of his Category 3 benefit would be calculated.

STEP ONE - ELIGIBILITY FOR A CATEGORY 3 BENEFIT

Section 4044(a)(3) applies to a participant who either "was in pay status as of the beginning of the 3-year period ending on the termination of the plan" or "would have been in pay status as of the beginning of such 3-year period if the participant had retired . . . [before the period began]."

Consequently, a participant's eligibility [*2] for a Category 3 benefit would be determined under the plan provisions in effect three years before the plan termination date.

For example, five years before termination, a plan's normal retirement benefit provided an immediate monthly annuity to a participant at age 65. The plan had no early retirement or deferred vested benefits. Four years before termination, the plan was amended to provide that a participant with thirty years of service could retire and receive an immediate monthly annuity.

At termination, Participant R was 68, and had retired three years ago. Participant Z was 56, with 33 years of service, and still employed.

As of three years before termination, R and Z were each eligible to retire and receive an immediate monthly benefit. Consequently, each would be eligible for a Category 3 benefit.

STEP TWO - THE AMOUNT OF A CATEGORY 3 BENEFIT

Section 4044(a)(3) provides that the amount of a Category 3 benefit is dependent on the plan provisions in effect during the five years preceding termination. The amount of the participant's Category 3 benefit is the lowest benefit that was in effect during the five year period. Consequently, in calculating the amount [*3] of a Category 3 benefit, a plan amendment adopted during the five years preceding plan termination that improves plan benefits would not be given effect.

For example, five years before termination, a plan provided a normal retirement benefit of a monthly annuity of \$8 times years of service. Four years before termination, the plan was amended to provide a normal retirement benefit of a monthly annuity of \$9 times years of service.

In calculating the amount of a participant's Category 3 benefit, the amendment would not be given effect. A participant's Category 3 benefit amount would be a monthly annuity of \$8 times years of service.

APPLICATION IN SPECIFIC SITUATIONS

A. Situation One

In some plans, the lowest benefit in effect during the five years before termination may have provided for automatic increases in the benefit payment level for both active and retired participants.

Section 4044(a)(3) provides that the Category 3 benefit payment level be limited to the level in effect 3 years before termination. As the benefit payment level three years before termination would include each payment level increase effective during the fourth and fifth years preceding termination, [*4] a participant's Category 3 benefit amount would include such increases. See Preamble to the proposed PBGC Allocation of Assets Regulation, 40 Fed Reg 51368 (1975), at 51369.

For example, during the five years before termination, the lowest benefit in effect was a monthly annuity with a payment level of \$8 times years of service during the fifth year before termination. The plan's benefit provision further stated that the payment level for both active and retired participants would increase each year by \$1 times years of service.

As the lowest benefit in effect during the five years preceding termination provided that the payment level would increase, each increase effective during the fourth and fifth year before termination would be included in the Category 3 benefit amount. Consequently, the amount of a participant's Category 3 benefit would be a monthly annuity of \$ 10 times years of service.

B. Situation Two

Another situation that may arise would be an amendment that both (1) changes a plan's eligibility provision and (2) improves the Plan's benefits. Were such an amendment adopted at least three, but less than five years before termination, it would affect the [*5] plan's Category 3 benefits.

As eligibility for a Category 3 benefit is measured as of three years before termination, a participant eligible to receive an immediate monthly annuity under the amendment would be eligible for a Category 3 benefit.

Such a participant's Category 3 benefit would be an immediate annuity, payable on the day that the participant was eligible to receive an immediate annuity under the plan as amended. The amount of the Category 3 annuity would not be the amount the amendment provides. This is because the benefit that the amendment provides would not be the lowest benefit in effect during the five years preceding termination.

The amount of the annuity would be * * *

(a) an immediate annuity, payable when the participant has satisfied the plan's eligibility requirements as of three years before termination, * * * that is the actuarial equivalent of * * *

(b) the lowest benefit in effect during the five years before termination, which a participant would have received at retirement, had the plan not been amended.

For example, five years before termination, a plan provided a normal retirement benefit to employees retiring at age 65 of \$300 a month. The [*6] plan had no early retirement or deferred vested benefits.

Four years before termination, the plan was amended to provide that a participant with 30 years of service, could retire and receive \$500 a month until age 65, and \$400 a month thereafter.

At plan termination, Participant Z was age 56 and had 33 years of service. As Z was eligible to receive an immediate monthly annuity three years before termination, he is eligible for a Category 3 benefit.

Three years before termination, Participant Z's plan benefit would have been \$500 a month until age 65, and \$400 a month thereafter. As that benefit is not the lowest benefit in effect during the five years preceding termination, it would not be Participant Z's Category 3 benefit amount.

Consequently, Participant Z's Category 3 benefit amount would be equal to the value of an immediate annuity, payable when Z completed 30 years of service, that is the actuarial equivalent of a monthly annuity of \$300 that would be payable at age 65.

I trust this is of assistance.

Henry Rose
General Counsel