

Pension Benefit Guaranty Corporation

91-1

January 14, 1991

REFERENCE:

[*1] 4022 Benefits Guaranteed Benefits Guaranteed
4061 Benefit Payments by PBGC Benefit Payments by PBGC
>29 CFR Part 2613>

OPINION:

The Executive Director has referred your letter of December 11, 1990 to me for reply. You have asked that we clarify the PBG's position with respect to annuities purchased by plan administrators to satisfy their obligation to participants and beneficiaries in terminating pension plans. Specifically, you ask whether the PBGC is obligated to pay pension benefits provided by insurance company annuities if the insurance company fails, and if not, whether the PBGC is prohibited from doing so. After completing a thorough legal analysis of the statutory provisions under which the PBGC single-employer termination insurance program is administered, we have concluded that the statute does not authorize PBGC to guarantee benefits distributed in the form of irrevocable annuity contracts from insurance companies. A summary of our analysis follows.

Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA") (29 U.S.C. § § 1301-1461), which established the PBGC and its insurance programs, requires the PBGC to guarantee the payment of basic pension benefits when a [*2] covered single-employer pension plan terminates with insufficient assets to pay for those benefits. Under those circumstances, the PBGC normally assumes trusteeship of the plan and pays guaranteed benefits in the form of a monthly benefit. See generally ERISA § § 4022, 4041(c), 4042, 4044, 4061. If a covered plan terminates with sufficient assets to pay for all benefits under the plan, including those in excess of guaranteed benefits, ERISA provides that PBGC shall oversee the plan administrator's allocation of plan assets and distribution of benefits, to ensure that plan participants receive the proper benefits upon termination. See generally ERISA § § 4041(b), 4044.

Since the inception of the single-employer insurance program, the program's "insurable event" has been plan termination. Thus, for example, ERISA § 4022(a) provides: "Subject to the limitations contained in subsection (b), the [PBGC] shall guarantee in accordance with this section the payment of all nonforfeitable benefits (other than benefits becoming nonforfeitable solely on account of the termination of a plan) under a single-employer plan which terminates" (Emphasis added.) Similarly, ERISA [*3] § 4061 provides that "[t]he [PBGC] shall pay benefits under a plan terminated under this title subject to the limitations and requirements of subtitle B of this title." (Emphasis added.) Nowhere in the statute is PBGC authorized to pay benefits upon the occurrence of any other event, such as the failure of an insurance company.

In a "standard" termination, where plan assets are sufficient to satisfy all of the plan's benefit liabilities, the plan administrator is required to distribute all plan assets in satisfaction of all plan benefits. See Allocation of Assets, Supplemental Notice of Proposed Rulemaking, 41 Fed. Reg. 48492 (November 3, 1976); 29 C.F.R. § 2618.3(b) (proposed as 29 C.F.R. § 2608.(b)); Determination of Plan Sufficiency and Termination of Sufficient Plans, Proposed Rulemaking, 41 Fed. Reg. 48504 (November 3, 1976); 29 C.F.R. § 2617.4 (proposed as 29 C.F.R. § 2615.3). These rules were codified by the Single-Employer Pension Plan Amendments Act of 1986 (Pub. L. 99-272). See ERISA § 4041(b)(3). This final distribution of all plan assets completes the plan termination process, and accordingly extinguishes the PBGC's statutory guarantee obligation. See [*4] 29 C.F.R. § § 2617.20-2617.23. n1

n1 Similarly, a complete distribution of an individual's benefit in an ongoing plan satisfies, and therefore extinguishes, the obligation of both the plan and the PBGC to that individual, even if the plan subsequently terminates. "Participant" is defined in ERISA § 3(7) to mean an individual who is or may become eligible to receive a benefit from a plan. The agencies charged with the administration of ERISA (the Department of Labor, the Internal Revenue Service, and the PBGC) have consistently interpreted this to exclude those individuals whose benefits have been fully satisfied by the purchase from an insurer of an irrevocable commitment to pay those benefits. See 29 C.F.R. § 2610.2; Form 5500 (issued jointly by DOL, IRS, and PBGC). See also ERISA § 4044(d)(3). Indeed, because the individual ceases

to be a participant in the plan once an irrevocable annuity contract is purchased in complete satisfaction of his or her benefit, no further PBGC premiums are paid with respect to that individual. 29 C.F.R. § 2610.2, 2610.22, 2610.32.

Thus, the PBGC was established to guarantee basic benefits in plans that terminate with insufficient funds [*5] to pay those benefits, and to oversee the proper allocation and distribution of plan assets to cover those benefits in sufficient terminating plans. The "insurable event" is plan termination which, in the case of a sufficient plan, is completed upon final distribution of assets in payment of all benefits under the plan through the purchase of annuity contracts or the distribution of lump sum amounts. The distribution of plan assets in the correct amount and proper form extinguishes the PBGC's guarantee obligation. For example, PBGC does not stand behind benefits distributed in a lump sum payment, nor protect from subsequent loss a participant who chooses to "roll over" a lump sum distribution into an Individual Retirement Account. Similarly, the failure of an insurance company subsequent to a proper distribution of plan assets through the purchase of annuity contracts does not result in an insurable event or reinstate the PBGC guarantee. n2

n2 Cf. ERISA § 4041(b)(4) (PBGC remains obligated to insure the payment of guaranteed benefits only if the plan administrator has not made a proper distribution, i.e., if a participant is overlooked or paid an incorrect amount and if the plan administrator does not promptly correct the error in distribution). H.R. Rep. No. 99-241, Part 2, 99th Cong., 2d Sess., reprinted in, 1986 U.S. Code Cong. & Admin. News 706. [*6]

It is clear from the manner in which the PBGC's single-employer insurance program is financed that Congress did not intend for PBGC to guarantee benefits that have been satisfied by a full distribution of plan assets upon plan termination. The PBGC's guarantee is financed primarily through the payment of premiums by covered plans. ERISA § 4007(a) provides: "Premiums shall continue to accrue [for a sufficient plan] until a plan's assets are distributed pursuant to a termination procedure [under section 4041(b)]." Thus, once a sufficient plan has terminated in a standard termination, no further premiums are paid with respect to that plan. Obviously, had Congress intended the PBGC to guarantee against a subsequent failure of the insurance company from which annuities were purchased, it would have designed a premium structure to protect PBGC against that continued exposure. n3

n3 In this regard, we also note that the PBGC has no regulatory authority over insurance companies.

Since ERISA's enactment in 1974, the amount of the annual premium owed by a plan has been based on the number of participants in the plan. ERISA § 4006. And, until 1987, the premium was simply a flat rate [*7] dollar amount, per year, per participant. In 1987, however, Congress enacted the Pension Protection Act (Subtitle D of Title IX of OBRA 1987, Pub. L. 100-203) ("PPA"). As part of the PPA reforms to strengthen the single-employer insurance program, Congress amended ERISA § 4006 to revise the single-employer plan premium structure. Under the revised structure, the existing flat rate premium was supplemented by an additional premium amount that is based on a plan's unfunded vested benefits. n4 Congress thereby reinforced the concept that premiums are based on PBGC's exposure from insufficiently funded plans. Had Congress intended for PBGC to insure against the failure of insurance companies from which annuities have been purchased, it surely would have also addressed the liabilities to which this would expose the PBGC. Significantly, we have estimated that that exposure could be as high as \$ 50 billion.

n4 The premium amount was increased by section 12021 of The Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508.

As note, in a 1981 preamble to PBGC's sufficiency regulation, the PBGC responded to a comment on an earlier notice of proposed rulemaking by indicating that [*8] we would pay guaranteed benefits in the event that an insurance company should fail and the state reinsurance fund did not satisfy the annuity obligations. See 46 Fed. Reg. 9532, at 9534 (January 28, 1981). We have searched PBGC records and found no legal memoranda or other document to support this statement. And, after a detailed and extensive legal analysis of the statutory provisions, we have reached a contrary conclusion. Thus, the statement in the preamble was made without legal analysis, and was simply incorrect.

Please do not hesitate to let me know if you have any further questions about this matter.

Carol Connor Flowe
General Counsel