Legislating Reversions: A Mistken Path Leading to Drastic Results

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Any changes in the law to require sponsors to share reversions with participants could create the wrong funding incentives which could further threaten [the Pension Benefit Guarantee Corporation's] financial security. Employers faced with owing more than they promise are likely to deliberately cut back on funding. The result would be that the participants will be less protected and [the Pension Benefit Guarantee Corporation's] exposure will be increased.1

INTRODUCTION

The reversion2 of excess assets following the termination3 of a qualified4 single employer5 defined benefit6 plan is presently an is-

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2. For the purposes of this Comment, “reversion” means returning to the sponsoring employer excess assets which remain after termination and satisfaction of all the liabilities of a defined benefit pension plan. The reversion is allowed under the rationale that the excess funds are in the trust due to “erroneous actuarial computations.” 26 C.F.R. § 1.401-2(b) (1987).

3. For the purposes of this Comment, “termination” will be defined as the cessation of the plan followed by the appropriate filings with the Internal Revenue Service (IRS) and, if applicable, the Pension Benefit Guarantee Corporation (PBGC). See infra note 110 and accompanying text.

4. For the purposes of this Comment, the term “qualified” defines a pension plan which meets the requirements of the Internal Revenue Code (IRC) for favorable tax status, as defined in 26 U.S.C. § 401(a) (1986). All references to plans assume that the
sue of heated debate within Congress and the pension community. The debate centers around disposition of any excess assets remaining after a plan is terminated and all its liabilities are paid. The alternatives include: (1) retaining the status quo by allowing employers to recapture excess assets; (2) changing the system by allocating excess assets to plan participants; or (3) a hybrid method allowing plan participants and the employer to “share” the excess funds.

The Employee Retirement Income Security Act of 1974 (ERISA), along with similar provisions in the Internal Revenue Code (IRC), permits employers to receive reversions in terminated, overfunded defined benefit pension plans. However, over the years an increasing number of groups have advocated changing ERISA and IRC provisions to block further defined benefit plan reversions.

plan is qualified. Nonqualified plans are beyond the scope of this Comment.

5. This Comment will be limited to single employer plans. Single employer plans are plans adopted by one sponsoring employer. Multiemployer plans are beyond the scope of this Comment.


Defined benefit plans are part of a larger grouping of plans entitled pension plans. A pension plan is defined as follows:

A plan designing to provide benefits for employees... will, for the purposes of Section 401(a), be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits. 


7. For the purposes of this Comment, “plan liabilities” will be defined as the total of participant benefits due plus any other plan expenses owed at the time of plan termination.

8. A simple hypothetical involving a reversion follows: A defined benefit pension plan which is established in 1980 has total trust assets of $100,000 in 1988. The total benefits earned (accrued) by the plan participants are only $75,000. The plan sponsor who wishes to recapture this excess money will proceed to terminate the plan, pay out all plan benefits ($75,000), and then take the remaining assets as the reversion ($25,000).


10. For the purposes of this Comment, the term “overfunded” will refer to a defined pension plan in which the plan assets exceed plan liabilities.


12. See PBGC Proposal to Initiate a Variable Rate Premium System; and Public Comments on Administration's Pension Plan Funding and Premium Rate Proposals: Hearings Before the Subcomm. on Oversight of the House Comm. of Ways and Means, 100th Cong., 1st Sess. 293 (1987) [hereinafter PBGC Proposal Hearing] (statement of Jacob Clayman, President of the National Council of Senior Citizens); see also PBGC Proposal Hearing, supra, at 295 (statement of Pension Rights Center); Comment, Pen-
Proponents of changing the system rely on ERISA\textsuperscript{13} and IRC\textsuperscript{14} provisions requiring a plan to be installed for the exclusive benefit\textsuperscript{15} of the participants.\textsuperscript{16} They argue that any excess remaining in the trust, upon a plan termination, should be distributed to the participants of the plan.\textsuperscript{17} Additionally, they argue that plan sponsors abuse the system by terminating plans solely to access the excess funds, thus reducing the participants' retirement security.\textsuperscript{18}

Congress is moving to address the alleged problems with asset reversions.\textsuperscript{19} It has enacted legislation dealing with some of the perceived abuses.\textsuperscript{20} However, the outcry for drastic change persists. At this time, Congress appears to be leaning toward either severely restricting future reversions or disallowing them altogether.\textsuperscript{21} Judging from the last session of Congress, the current direction is toward

\textsuperscript{13} See infra note 81 and accompanying text.

\textsuperscript{14} See infra note 80 and accompanying text.

\textsuperscript{15} (a) Requirements for qualification:
A trust created or organized in the United States and forming part of a stock bonus, pension, or profit sharing plan of an employer for the exclusive benefit of his employees and their beneficiaries shall constitute a qualified plan under this section.

\textsuperscript{16} ERISA defines "participant" as:
any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may become eligible to receive any such benefit.

\textsuperscript{17} This argument usually comes in the form of the claim that contributions to the plan are in reality deferred wages for the employees; thus, any excess should revert to them. Additionally, the argument is made that the excess should be used as cost of living increases to the benefits earned under the plan. These cost of living increases would help protect the benefits from the adverse effects of inflation. See infra note 103.

\textsuperscript{18} See infra notes 101-03 and accompanying text.

\textsuperscript{19} Congress has addressed reversions in both hearings and legislation. Reversions have been the topic of recent congressional hearings. See Subcommittee, supra note 1; see also PBGC Proposal Hearing, supra note 12. Legislation has also addressed the reversion issue. See infra note 163.

\textsuperscript{20} See infra notes 100 (five year amendment period), 164 (excise tax on reversions) and accompanying text.

\textsuperscript{21} Judging from past legislative attempts to alter the law regarding reversions, there is no reason to believe the attempts to change the law will cease. See 17 Pens. Rep. (BNA) 157 (Jan. 15, 1990) (indicating that Sen. Metzenbaum plans to react quickly with regard to new reversion legislation).
limiting the amount of any reversion that a plan sponsor may take. In any event, recent legislation increased the excise tax applicable to reversions. In addition, the Treasury Department recently issued an order temporarily suspending all IRS determination letters for terminations with reversions.

During its next session, Congress should think twice before taking actions which eliminate or severely restrict asset reversions. The result of major changes in the current law may be more detrimental to plan participants than the currently perceived inadequacies of the system; any changes should take the following factors into consideration.

First, Congress must remember that an underlying purpose of ERISA was to stabilize the funding of defined benefit plans. One byproduct of the promotion of adequate funding of defined benefit plans is occasional overfunding due to increases in trust investment return or other circumstances. There is a strong preference in favoring overfunding, as opposed to underfunding, plans. However, underfunding is the likely result of changes that eliminate reversions.

Second, the potential for underfunding defined benefit plans may result in additional financial drain on the Pension Benefit Guarantee Corporation (PBGC). The PBGC was set up by ERISA to guaran-

22. See infra notes 173-81 and accompanying text. Even though the recently passed budget reconciliation legislation deleted the reversion bills, it is highly likely they will be reintroduced in the current session. See supra note 21.

23. The excise tax applicable to reversions has been increased from 10% to 15%. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6069, 102 Stat. 3702.

24. The determination letter states the IRS's opinion that the termination and distribution meet IRC requirements, thus indicating that the plan's tax qualified status remains intact.

25. The Treasury notice reads in pertinent part:
The Department of the Treasury today announced it has directed the Internal Revenue Service to delay until May 1, 1989 the issuance of determination letters for terminating defined benefit plans with assets in excess of liabilities if all or a portion of the excess assets are to be recovered by the employer. While the Treasury believes the current policies regarding plan terminations are sound and does not anticipate any changes in this area, the delay in the issuance of the letters until May 1, 1989 will provide an opportunity for additional review of the guidelines applicable to determination letters for terminating plans.


26. See infra notes 183-98 and accompanying text.

27. See infra notes 214-23 and accompanying text.

28. See infra notes 66-73 and accompanying text.

29. For the purposes of this Comment, "underfunding" occurs when plan liabilities exceed plan assets in a defined benefit plan.

30. The Pension Benefit Guarantee Corporation (PBGC) was established by ERISA:

(1) [T]o encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,

(2) to provide for the timely and uninterrupted payment of pension benefits to
tee specific benefits in defined benefit plans. Currently, the PBGC has a four billion dollar deficit due to the termination of previously underfunded plans. Removing asset reversions from the scene, and the likely resultant underfunding of future plans, will require the PBGC to pay even more guaranteed benefits, thus increasing its deficit.

Third, due to the above factors, the real losers from reversion legislation may be those this legislation seeks to assist, the plan participants. Certainly, in the short term, such legislation will benefit participants in those plans with a large excess. However, if subsequent plans terminate with assets insufficient to cover liabilities, the plan participants end up losing.

This Comment will address reversion issues in light of the above mentioned factors. Part I outlines the unique nature of defined benefit plans and introduces reasons why these plans become overfunded. Part II discusses many of the perceived abuses in the current system which caused the outcry for change. Part III addresses the current and future legislative atmosphere as it relates to reversion issues. Part IV analyzes the likely results of future congressional legislation affecting reversions. Part V presents some alternate suggestions, which avoid serious harm to the private retirement system, for remediating the alleged abuses.

This author fears that any significant changes in the law regarding reversions will be highly detrimental to all concerned in the private pension system, plan participants and plan sponsors alike. Congress should look toward alternate methods for increasing benefit security for participants while continuing strong incentives to sponsoring employers. The suggested direction will help the system develop and flourish; an alternate course may destroy much of the progress already made toward benefit security.

participants and beneficiaries under plans to which this title applies, and to maintain premiums established by the corporation under section 4006 [29 U.S.C. § 1306] at the lowest level consistent with carrying out its obligations under this title.


31. Id.
32. PBGC Proposal Hearing, supra note 12, at 3 (statement of Chairman Pickle).
33. As will be seen, if the PBGC must pay out the benefits of an underfunded plan, those benefits are capped at a certain level and are limited to only those benefits which were vested before the plan terminated. Participants do not receive the benefit of full 100% vesting as they would if the plan sponsor paid benefits (assuming the plan is either well funded or underfunded but above the PBGC limits). See infra notes 190, 191 and accompanying text.
I. THE NATURE OF THE BEAST AND THE ROOTS OF THE PROBLEM

A. The Defined Benefit Pension Plan

The unique nature of the defined benefit pension plan provides the forum for the accumulation of excess assets which may result in a reversion upon the plan's termination. First, as in all private retirement plans, a sponsoring employer's adoption of a defined benefit plan is voluntary. There are no requirements forcing an employer to adopt such a plan. However, once the plan is voluntarily adopted, certain statutorily imposed requirements must be met.

1. The Benefit Promise: Definitely Determinable Benefits

A defined benefit plan promises to pay a participating employee a specific benefit at retirement. This benefit is calculated based on a formula stated in the plan document. Typically, this benefit calculation is based on the participant's compensation, service, or a combination of the two. ERISA and the IRC both require these benefits to be definitely determinable. Under this requirement, "benefits are not definitely determinable if funds arising from forfeitures on termination of service, or other reasons, may be used to provide increased benefits for participants." In other words, the participant's benefit must be determined solely by the benefit formula and accrual provisions in the plan document and may not

34. The term "private" refers to a plan established by any nongovernmental entity. A "public" plan is a plan adopted by a governmental agency or unit.
35. If the plan is to be qualified for favorable tax treatment under the Internal Revenue Code, it must meet the requirements of I.R.C. § 401(a), 26 U.S.C. § 401(a) (1986).
36. See supra note 6.
37. See supra note 6.
38. ERISA provides that "[e]very employee benefit plan shall be established and maintained according to a written instrument." ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1) (1982).
39. For a discussion of the factors that are included in benefit calculation along with the general types of benefit formulas, see F. Foulkes, EMPLOYEE BENEFITS HANDBOOK § 10-10-13 (1982); see also M. Canan, QUALIFIED RETIREMENT PLANS § 3.52 (West 1977 & Supp. 1982).
41. "Forfeitures" will be defined as follows: Forfeitures are amounts contributed by the employer to provide benefits for participants who terminated their employment before obtaining a vested right to the contributions. Under a profit sharing plan, forfeitures may be used either to reduce employer contributions otherwise required or to increase the individual accounts of remaining participants. . . . This flexibility is not available in pension plans, which must use forfeitures to reduce employer contributions. See F. Foulkes, supra note 39, at § 12-11.
42. The term "termination of service," as used in this quote, refers to the employee's termination from employment with the employer.
increase due to forfeitures or any other factors.

2. Benefit Accrual and Vesting

In most instances, a participant is not entitled to a full benefit until retirement age is attained. The participant earns, or accrues, a portion of her benefit, usually with each year of participation in the plan. Along with benefit accrual, vesting provides a method through which participants obtain nonforfeitable rights to their accrued pension benefits. Upon plan termination, the partici-

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44. Retirement age may vary from plan to plan. However, both ERISA and the IRC specify maximum normal retirement ages which plans may not exceed. ERISA provides:

(a) Commencement date for payment of benefits. Each pension plan shall provide that unless the participant otherwise elects, the payment of benefits under the plan to the participant shall begin no later than the 60th day after the latest of the close of the plan year in which:

(1) the date on which the participant attains the earlier of age 65 or the normal retirement age specified under the plan, or
(2) occurs the 10th anniversary of the year in which the participant commenced participation in the plan, or
(3) the participant terminates his service with the employer.


45. ERISA defines “accrued benefit” as “(A) in the case of a defined benefit plan, the individual’s accrued benefit determined under the plan and. . . [is] expressed in the form of an annual benefit commencing at normal retirement age . . . .” ERISA § 3(23), 29 U.S.C. § 1002(23) (1982). Both ERISA and the IRC provide methods for the calculation of the participant’s accrued benefit. ERISA § 204, 29 U.S.C. § 1054 (1982); 26 U.S.C. § 411(b) (1986). These rules provide the methods for the calculation of the portion of the participant’s normal retirement benefit which the participant has earned to date.


47. Id. at 14-7, 14-8.

48. Vesting is the percentage of the participant’s accrued benefit which has become nonforfeitable. Both ERISA and the IRC provide a variety of vesting schedules which define the parameters of vesting as well as apply to various special circumstances. ERISA § 203, 29 U.S.C. § 1053 (1982 & Supp. 1988); 26 U.S.C. § 411(a) (1986).

49. The term “nonforfeitable” is defined as “a claim obtained by a participant or his beneficiary to that part of an immediate or deferred benefit under a pension plan which arises from the participant’s service, which is unconditional, and which is legally enforceable against the plan.” ERISA § 3(19), 29 U.S.C. § 1002(19) (1982).

50. An example of how vesting and benefit accrual operate may be helpful. Assuming a vesting schedule which provides the plan participant with 20% vesting after two years of service with the employer and 20% for each year of service thereafter (up to 100%), and the fractional method of benefit accrual, which creates a fraction of the participant’s years of participation over the participant’s total years of plan participation at normal retirement under the plan, an employee who becomes a participant at age 25 and whose plan benefit is $1,000 per month at a normal retirement age of 65 will vest and accrue a benefit as follows:

Year One: Since the participant will have 40 years of plan participation at normal retire-
pant receives 100% of his or her accrued benefit.  

3. Actuarial Calculations and Funding

The plan sponsor's contribution to the plan is based on an actuarial determination of the amount necessary to properly fund the participants' benefits at normal retirement age. A number of different methods for calculating the plan's contributions are allowed. In addition to employing an appropriate funding method, the actuary must utilize various other assumptions, all of which must be "reasonable." ERISA and the IRC also provide for a funding standard account for each plan. These funding standards are an attempt to insure adequate funding of defined benefit plans, thus assuring participants of the availability of adequate benefits at retirement.

B. The Defined Contribution Plan: A Contrast

In contrast to a defined benefit plan, a defined contribution plan provides for contributions to be made to a participant's individual account. For example, the accrual fraction on year one will be 1/40. The normal retirement benefit of $1,000 is multiplied by the accrual fraction resulting in an accrued benefit of $25. Since the vesting schedule requires two years of service for any vesting, the participant's accrued benefit is fully forfeitable.

Year Two: The accrual fraction in the second year of plan participation is 2/40, resulting in an accrued benefit of $50. Under the vesting schedule the participant's vested interest is 20% or $10.

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52. A variety of funding techniques are provided to allow actuarial flexibility in choosing an appropriate method to fit the anticipated plan experience. Section 412 of the Internal Revenue Code outlines pension funding requirements. 26 U.S.C. § 412 (1986 & Supp. 1988).
53. Besides the funding method, the actuary may employ additional assumptions such as preretirement and postretirement mortality, preretirement and postretirement interest, turnover, and salary. These assumptions are worked into the funding method to attempt to closely follow the actuary's estimate of actual plan experience.
54. [A]ll costs, liabilities, rates of interest, and other factors under the plan shall be determined on the basis of actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, in combination, offer the actuary's best estimate of anticipated experience under the plan.
56. See infra notes 215-17 and accompanying text; see also PBGC Proposal Hearing, supra note 12, at 218 (statement of the ERISA Industry Committee).
57. These funding standards provide incentives for the plan sponsor to prefund future benefits, thus in many cases creating overfunding simply by the nature of the funding method. See PBGC Proposal Hearing, supra note 12, at 218 (statement of ERISA Industry Committee).
58. The term "defined contribution plan" is defined as: a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's
Contributions are based on a specific formula described in the plan document. At retirement, the participant receives the total amount of money in the account as his or her retirement benefit. The risk of investment losses is borne by the participant, whereas in a defined benefit plan the employer bears the risk of investment losses. If the trust makes profitable investments, the participant’s retirement benefit increases. If investment performance is poor, the participant’s eventual benefit decreases. Under the individual account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants’ account.


The following testimony provides a synopsis of the contrast between defined benefit and defined contribution plans.

In defined contribution plans, plan assets contributed by the plan sponsor are allocated to the individual accounts of plan participants. In general, the benefits to be received by the participant are based on the amount contributed to the individual account, plus earnings and less losses and expenses. Once a participant becomes vested, he or she effectively owns the assets in the account; by definition there can be no asset reversion to the plan sponsor upon termination of a defined contribution plan.

In defined benefit plans, benefits under the plan accrue over the worklife of a participant according to a formula designed in the plan. When a participant vests in a defined benefit plan, he or she becomes entitled to nonforfeitable benefits payable at retirement. However, assets contributed by the plan sponsor are not allocated to individual accounts. Instead, they are required by ERISA to be held in trust for the purpose of funding the plan’s legal obligations to pay future benefits. This legal obligation to pay accrued benefits is independent of the amount of assets in the trust. Thus, in defined benefit plans, vested participants are entitled to a benefit, but they do not have a right to any specific portion of the trust assets.

Subcommittee, supra note 1, at 37 (statement of David M. Walker, CPA, Assistant Sect’y for Pension and Welfare Benefits, U.S. Dep’t of Labor).

This formula may be a specific contribution formula (i.e., 10% of pay) or an allocation formula (i.e., the contribution will be allocated to each participant in the ratio of his or her compensation over the total participating compensation).

As required for a defined benefit plan, a defined contribution plan also requires a written plan document. See supra note 38.

The eventual benefit received from a defined contribution plan is determined by employer contributions, forfeitures, and investment gains or losses. In contrast, the benefit received from a defined benefit plan is expressed when the participant enters the plan and does not change due to any of the above factors (changes in the participant’s compensation may result in changes in the eventual benefit received).

See F. FOULKES, supra note 39, at § 12-13. In defined benefit plans, the plan sponsor bears the risk of investment performance by adjusting plan contributions according to the actual experience of the plan compared with the actuary’s projections of plan experience. Thus, if, for instance, the trust investment return is lower than projected, the sponsor must make up the difference in the plan contribution. The converse is also true if the plan assets receive a return higher than projected (the method in which the sponsor pays this reduced contribution is dependent upon the funding method chosen).

Thus, in the defined contribution plan the participant does not know what the retirement benefit will be until retirement. In contrast, the defined benefit participant's
individual account method there can be no excess assets; all assets must be allocated to participants' accounts. Thus, there are no reversions in defined contribution plans.

C. How Reversions Occur

Technically, reversions occur when excess assets remain after plan termination and all plan liabilities have been extinguished. This section examines actions prior to plan termination that result in overfunding. Most commentators agree the primary reason for overfunded plans is the large investment yield which pension trusts received in recent years. According to the American Society of Pension Actuaries (ASPA), greater real rates of return than predicted by plan actuaries and plan sponsors are responsible for this overfunding. Other explanations for overfunded defined benefit plans include the maturation of many plans which existed since the 1940s and 1950s, the use of conservative actuarial assumptions by plan actuaries, and recent legislation cutting back maximum benefit limitations. Indeed, often many or all of these factors com-

benefit at retirement is spelled out in the plan document at the inception of the plan (of course, benefits will change according to compensation changes and any modifications in the plan that affect retirement benefits). Therefore, in a defined benefit plan there is no real relation between the participant's benefits and the actual trust assets. The benefits are calculated solely on the basis of the plan benefit and accrual formulas, while in the defined contribution plan the trust assets equal the total accounts of all the participants.

65. See supra note 59 and accompanying text.
66. See Comment, supra note 12; Stein, supra note 12, at 119; 60A AM. JUR. 2D Pensions and Retirement Funds § 949 (1988); AMERICAN SOCIETY OF PENSION ACTUARIES, ASSET REVERSIONS FROM DEFINED BENEFIT PENSION PLANS: PROPOSALS OF THE AMERICAN SOC'Y OF PENSION ACTUARIES 1, 6 (1985) [hereinafter ASPA]. This proposal, addressing the issues confronting reversion of excess assets from a defined benefit plan, makes suggestions for improving the system to better effectuate the participants' and the private pension system's interests.
67. "The American Society of Pension Actuaries is a non-profit organization whose 2,700 members provide actuarial, consulting and administrative services to approximately 30% of the qualified retirement plans in the United States." American Soc'y of Pension Actuaries, Memorandum to All Senators (Sept. 6, 1988) (on file with author).
68. As used in the ASPA proposal and this Comment, "real rate of return" signifies the amount by which the return on investment exceeds the rate of inflation. ASPA, supra note 66, at 6.
69. Id.
70. Id.
71. ERISA funding standards leave considerable latitude to a company to choose among permissive funding methods. Actuaries have tended to err on the conservative side (that is, to require contributions on the high end rather than the low end within the range of reasonable actuarial calculations).
72. See also supra notes 52, 53 and accompanying text.
73. Both the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and the Tax Reform Act of 1986 (TRA 86) place significant reductions on the maximum allowa-
bine to contribute to plan overfunding.

D. General Plan Requirements to Take a Reversion

In order for a plan to qualify as a bona fide pension program permitting a reversion upon termination, the plan provisions must meet the specific requirements of ERISA and the IRC. The plan must be permanent and be established for the exclusive benefit of employees.

1. The Requirement of Permanence

First, in order for a plan to be qualified, it must be permanent. The requirement of permanence does not abridge the plan sponsor’s right to terminate or amend the plan. However, if the plan is terminated “for other than business necessity within a few years after it has taken effect,” the plan may not be considered a bona fide retirement program. Thus, the requirement of permanence only affects the decision to terminate a plan if it is determined that the plan was never a bona fide retirement program.

2. Exclusive Benefit Requirement

Second, a plan must be established for the exclusive benefit of the employees and their beneficiaries. However, under the IRC, an exception is made for cases in which the plan has satisfied all plan liabilities to the employees and their beneficiaries. Likewise, a similar exception exists in ERISA, which allows reversions if: “(A) all liabilities of the plan to participants and their beneficiaries have been satisfied, (B) the distribution does not contravene any provision of law, and (C) the plan provides for such a distribution in these circumstances.” These exceptions to the exclusive benefit provisions

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75. The IRC requires a plan to include certain provisions in order to qualify for favorable tax treatment. 26 U.S.C. § 401(a) (1986).
77. Id.
form the basis for the reversion of excess assets. Thus, the exclusive benefit rule applies while the plan is still in operation, but the exceptions provide a method for the employer to receive the excess assets when the plan is terminated and all liabilities are paid.

3. The Plan Instrument Must Allow Reversions

However, the exceptions to the exclusive benefit rule alone are not enough to allow a reversion of excess assets to the sponsoring employer after termination of the plan. Both ERISA and the IRC require a plan to be established and maintained according to a written instrument. In addition, the plan document must expressly provide for a reversion; without such a provision, no reversion may take place. The provision allowing for reversions need not be in the original plan instrument; provisions for the amendment of the plan document are outlined in ERISA and the IRC.

The federal courts have heard a number of cases seeking to limit plan sponsors' rights to amend the plan document and provide for reversions. These cases can be divided into three general groups. First, courts have dealt with claims in which the original plan document provisions expressly denied the plan sponsor the right to amend the plan to allow for reversions. Second, courts have ruled on pretermination amendments made to allow for reversions. Third, courts have ruled on post-termination attempts to authorize reversions to the plan sponsor.

The federal courts have rejected an employer's claim for a reversion when the plan document specifically stated that no reversion could go to the employer. However, a federal circuit court, in Wil-

82. See supra note 38.
83. International Union v. Dyneer Corp., 747 F.2d 335 (6th Cir. 1984) (plan provision permitting excess assets to be returned to employer as a result of actuarial error was sufficient to allow the reversion); Eager v. Savannah Foods & Indus., 605 F. Supp. 415 (N.D. Ala. 1984) (plan provision allowing for the return of excess assets satisfied ERISA notwithstanding that the plan provisions were contradictory to the Summary Plan Description); District 65, UAW v. Harper & Row Publishers, 574 F. Supp. 1468 (S.D.N.Y. 1983) (express plan provision permitting the return of excess assets to the employer held sufficient).
86. See infra note 89 and accompanying text.
87. See infra note 94 and accompanying text.
88. See infra note 97 and accompanying text.
The court distinguished Bryant on the grounds that the nonreversion provision was not included in the Bluefield plan.


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An amendment to an existing plan to provide for reversion of excess plan assets (upon plan termination) does not become effective until five calendar years from the date of amendment.

Therefore, a plan sponsor who wishes to terminate a defined benefit plan, and who has no provision providing for a reversion, is unable to take a reversion for at least five years after amending the existing plan.


collective bargaining agreement).

90. 819 F.2d 457 (4th Cir. 1987).
91. Id. at 462. The court distinguished Bryant on the grounds that the nonreversion provision was not included in the Bluefield plan.
93. Id. (provision in the plan instrument prohibiting fund from returning to the employer after a plan termination only applied to the case of an amendment to reduce benefit).
96. Id. at 262.
97. Audio Fidelity Corp. v. PBGC, 624 F.2d 513 (4th Cir. 1980).
100. Id. The plan sponsor may still terminate the plan, however, no reversion may take place. The excess assets would be distributed among the participants of the plan.
Having examined the defined benefit plan (contrasting it with the defined contribution plan), how a reversion occurs, and the plan requirements for taking reversions, it is now necessary to review the complaints about reversions and the methods by which an employer may take a reversion. Part II will discuss both.

II. ABUSING THE SYSTEM

A. Introduction: The Complaints

The outcry for change in the current law allowing reversions results from a number of perceived abuses of the system. These abusive practices are claimed to reduce participants' retirement security by allowing termination of plans with employers taking reversions which should go to the participants.101 When this happens, the participant is not able to enjoy the full benefit that was promised at retirement. Additionally, it is urged, that excess assets reverting to the plan sponsor should be distributed to plan participants as cost of living increases.102 Finally, there is the theory that plan sponsors should make contributions to fund employees' benefits and not to create windfalls for themselves.103

The proponents of changing the system cite a number of different techniques plan sponsors use to receive excess assets.104 Among those techniques are spinoff/termination,105 termination/replacement,106 and simple termination with no succeeding plan.107 An additional irritant to these groups is that the sole purpose of these terminations is to acquire the excess money.108 They argue the ease with which employers can access the excess assets makes it too simple for an employer to decide to terminate the plan and receive the reversion.109

101. Stein, supra note 12, at 130; see also Comment, supra note 12, at 259.
103. See PBGC Proposal Hearing, supra note 12, at 293 (statement of Clayman, J., Nat’l Council of Senior Citizens, claiming that pension plan assets are deferred wages of the participants, thus, any excess should go to the participants); see also Comment, Reversion of Surplus Pension Assets Upon Plan Termination: Is it Consistent with the Purpose of ERISA?, 62 IND. L. REV. 805 (1987); Nobles, Who is Entitled to the Pension Fund Surplus?, 16 IND. L.J. (1987).
104. See infra notes 110-15, 133, 134, 154 and accompanying text.
105. See infra notes 133, 134 and accompanying text.
106. See infra note 154 and accompanying text.
107. See infra notes 110-15 and accompanying text.
109. There is no current requirement of business necessity to terminate a plan. Thus, it is claimed the employer can terminate solely for the purpose of getting at the excess funds. But see supra note 78 and accompanying text.
B. Techniques of Receiving Reversions

1. Simple Terminations

The most straightforward way to receive a reversion from an overfunded defined benefit pension plan is through a simple termination. As with any termination, specific requirements must be met by the employer when filing with the IRS and the PBGC. Benefits are calculated for each participant as of the termination date. In addition, all accrued benefits must vest 100% upon plan termination. After approval from the IRS and the PBGC, the plan must distribute its benefits to the participants. After benefit distribution, the employer may take the remaining assets as a reversion.

There is no statutory limitation on the plan sponsor's decision to terminate the plan. Groups advocating changing the law (in regard to reversions) cite examples of plan sponsors terminating plans...
solely to obtain the excess funds.117 There is some basis for this argument, especially in light of the many recent examples of employers terminating plans to avoid takeovers,118 after successful takeovers,119 and seemingly with no apparent reason other than to capture the excess funds.120 Recent legislative hearings indicate that in 1987 only 6.8% of businesses terminating pension plans stated the termination was due to business necessity.121 Additionally, it has been suggested that some employers may terminate their plans and take reversions because of uncertainty over the future of plan reversions and fear that the opportunity may be legislated out of existence.122

It should be noted that the fiduciary standards123 outlined in ERISA do not apply to decisions to terminate plans.124 The decision to terminate is generally considered a nonfiduciary business decision.125 Thus, the general requirement that plan fiduciaries act in the interest of participants and their beneficiaries126 does not apply.127 Besides a plan sponsor terminating the plan for no apparent reason other than to get at the reversion, it seems that the large dollar figures involved are what really shocks many opponents of reversions.128 An excellent example is the termination of the United Airlines plan which resulted in a reversion of $962 million.129 Reports indicate that between 1980 and 1988, approximately 1897 plans terminated, each with a reversion in excess of $1 million.130 From these

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117. *See infra* notes 132-33 and accompanying text.
119. After a takeover, the overfunded pension plan may be terminated in order to retire some of the takeover debt.
120. *See supra* note 103 and accompanying text.
121. *Subcommittee, supra* note 1, at 6 (statement of Bert Seidman).
122. It is no accident that there has been an increased incidence of reversion activity over the past two to three years. This increased termination activity corresponds with the time period during which we have heard serious proposals to undermine the ability of employers to recover reversions in the event of plan terminations. *See PBGC Proposal Hearing, supra* note 12, at 249 (testimony of Peter M. Kelly, Chamber of Commerce of the United States).
125. *Id.*
126. ERISA states "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries. . . ." ERISA § 404(a), 29 U.S.C. § 1104(a) (1982).
128. *See infra* notes 129, 130 and accompanying text.
129. *Stein, supra* note 12, at 119 (citing 12 Pens. Rep. (BNA) 837 (June 17, 1985)).
130. *Hearing on the Employee Pension Protection Act of 1989, S. 685 Before the
plans, the total amount taken by employers is close to $20 billion dollars. It shocks the conscience of many to see these large numbers. Even though the participants affected received their full earned benefits, many are disturbed by the belief that employers terminated these plans prematurely just to get at the huge excess.

2. Spinoff/Termination

The technique for receiving excess assets referred to as spinoff/termination is severely criticized. On one hand, critics claim this method is not really a termination at all. On the other, critics maintain these terminations present potential funding problems for the plan that continues to exist.

This method of termination involves splitting a single defined benefit plan into two plans. One plan includes only retired participants; the other includes all current participants. The catch is that the plan including all retirees also includes all the excess assets. As soon as the plans are spun apart, the plan with the retirees is terminated and the plan sponsor takes the reversion. The plan with the current participants continues as before, but without the benefit of the excess funds.
Opponents of this method of termination claim it is not a termination at all, but represents "form over substance." They claim the plan sponsor accomplishes in two steps what it could not accomplish in one. Namely, the sponsor is unable to take money from the trust without its prior termination. This method of termination allows the employer to get at the excess funds while still leaving intact a plan for current participants.

Another claim against spinoff/termination is that the plan remaining after the spinoff may have future funding problems. Since the plan is spun off from the terminating plan with assets sufficient only to meet current liabilities, a change in conditions may result in the plan being underfunded in the future. That is, after stripping the plan of excess assets, the employer may not properly fund future benefit accruals, thus possibly forcing participants to lose benefits.

In order to reduce some of the worry over spinoff/terminations, the PBGC, the Department of the Treasury, and the Department of Labor issued joint guidelines addressing the reversion issue under this termination method. These guidelines set out certain conditions as prerequisites for a valid spinoff/termination. First, all

Department of Labor, and the PBGC. In a PBGC News Release of May 24, 1984, joint guidelines were issued addressing the issues of spinoff/terminations, and of termination/reestablishments. PBGC News Release 84-23 (May 23, 1984).

The federal courts have approved this method in Foster Medical Corp. Employees' Pension Plan v. Healthco, Inc., 753 F.2d 194 (1st Cir. 1985); Bigger v. American Commercial Lines, 652 F. Supp. 123 (W.D. Mo. 1986).

Comment, supra note 12, at 268.

Id.; see also Stein, supra note 12, at 130.

See supra note 134.

This result may occur if the plan sponsor uses a more liberal set of actuarial assumptions or a funding method which will provide for lower annual contributions. Additionally, changes in the makeup of participants or future investment losses may also contribute to the underfunding of the existing plan.

"The ongoing plan is not required to retain any assets above the level of the plan's termination liability. The absence of any assets above this level may reduce employees' security with respect to future benefits and may also discourage employers from providing future benefit increases." McNeil & Griffin, Rules on Reversions Reexamined, 13 J. PENS. PLAN. & COMP. 291, 298 (1987).

PBGC News Release 84-23 (May 23, 1984).

In the case of a so-called "spinoff/termination," generally no termination will be recognized and any attempt to recover excess assets will be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and beneficiaries unless the following conditions are satisfied:

(1) The benefits of all employees (including those covered by the ongoing plan) must be fully vested and nonforfeitable as of the date of termination.

(2) All benefits accrued as of the date of termination in the ongoing plan must be provided for by the purchase of annuity contracts which represent irrevocable commitments for the benefit of each individual participant.

(3) All employees who are covered by the original plan must be given advance notice of the transaction in similar time and manner as if the entire original plan were being terminated.

Id; see also McNeil & Griffin, supra note 144, at 298.
benefits must be vested at the time of the termination.\textsuperscript{147} Second, all benefits accrued at the time of termination must be provided for by the purchase of annuity contracts.\textsuperscript{148} Third, notice must be given to the employees.\textsuperscript{149} Finally, the continuing plan must adopt a special funding method.\textsuperscript{150} The purpose of these guidelines is to secure for participants the same benefit rights they would be entitled to if the plan were to actually terminate. The funding requirements also attempt to avoid possible future underfunding of the continuing plan.

Congress has passed legislation dealing with the spinoff/termination.\textsuperscript{151} This legislation provides that plan assets must be proportionately distributed between the two plans.\textsuperscript{152} The method for such allocation is based on a proportion of the excess assets calculated according to each plan's ratio of total accrued benefits.\textsuperscript{153} This new provision responds to both complaints about the spinoff type transaction. First, the plan sponsor cannot get at all the excess funds, making termination under this method less tempting. Second, even if the spinoff method is employed, the remaining plan will have adequate remaining assets to avoid future funding difficulties.

The joint guidelines coupled with recent legislation make spinoff/termination much less desirable as a tool for receiving excess assets. However, the result may be to force an employer to terminate the plan altogether with participants being denied any future benefit accruals. This result is less than desirable.

3. Termination/Reestablishment

This method of termination has several steps: first, the defined benefit plan is terminated; second, the sponsor takes the reversion; and third, a similar defined benefit plan or a defined contribution

\begin{itemize}
\item \textsuperscript{147} PBGC News Release 84-23 (May 23, 1984).
\item \textsuperscript{148} Id.
\item \textsuperscript{149} Id.
\item \textsuperscript{150} Id. § 5(a), (b).
\item \textsuperscript{151} Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3702.
\item \textsuperscript{152} In the case of a plan spinoff of a defined benefit plan, a trust which forms part of:
\begin{enumerate}
\item the original plan, or
\item any plan spun off from such plan, shall not constitute a qualified trust under this section unless the applicable percentages of excess assets are [sic] allocated to each of such plans.
\end{enumerate}
\item \textsuperscript{153} Id. § 2005(c) (amending 26 U.S.C. § 414(i) (1988)).
\end{itemize}
plan is established. The same arguments raised against the spinoff/termination method apply here as well. First, this transaction is "form over substance." Second, there is great potential for underfunding the new plan. These concerns are valid since the replacement plan often provides the same, or similar, benefits as the terminated plan. However, the potential for funding problems does not exist if a defined contribution plan is established.

The joint guidelines issued by the Department of Labor, the Department of the Treasury, and the PBGC require termination/reestablishments to meet specific requirements. The termination/reestablishment must meet specific funding requirements. The guidelines also permit the new plan to "grant past service credit for the period in which the employee was covered by the terminated plan."

Complaints of abuse and the variety of techniques employed to take reversions have lead to a frenzy of legislative activity. One irony of this legislative activity is the current congressional focus on the use of a modified form of termination/reestablishment to address the reversion issue. Part III discusses the current legislative environment, focusing on recent modifications and pension policy.

III. THE CURRENT AND FUTURE LEGISLATIVE ENVIRONMENT

A. Legislative Frenzy

Congress has responded to calls for reform. In recent years, it has passed a considerable amount of legislation regarding private retirement plans. Included in this legislative frenzy are many provisions
dealing with plan terminations, and, more specifically, with reversions. Already noted is recent legislation affecting the excise tax an employer must pay upon receiving a reversion, a five year waiting period regarding the effectiveness of plan reversion amendments, and a provision providing for pro rata allocation of excess assets in a spinoff/termination. As will be seen, there have been a number of failed attempts to prohibit or severely restrict reversions. However, judging from the increased congressional interest in the reversion issue, more reversion legislation may be forthcoming.

164. See supra note 100 (five year amendment provision); supra note 152 (requiring proportional allocation of assets in a spinoff/termination); infra note 164 (excise tax reversions).


166. See supra note 152 and accompanying text.

167. The changes indicated above are no more than an effort to close loopholes or remedy perceived abuses. There is no indication that Congress will discontinue its interest in further legislating the pension area. Indeed, the need to find new revenues may be reason enough for Congress to keep a sharp eye on the pension arena as a potential source for deficit reducing legislation. A recent example of revenue driven “reform” is the amendment of the Internal Revenue Code section 133 deduction for leveraged Employer Stock Ownership Plan loans. Revenue Reconciliation Act of 1989, Pub. L. No. 101-239, §§ 7301-7304, 103 Stat. 2106.
B. Technical Corrections '88

The Technical and Miscellaneous Revenue Act of 1988\textsuperscript{168} increases the excise tax on the reversion of excess plan assets.\textsuperscript{169} This final provision replaced a Senate bill allowing for a temporary increase in the excise tax to sixty percent.\textsuperscript{170} The sixty percent provision itself replaced a bill imposing a temporary moratorium on reversions.\textsuperscript{171} Other legislative proposals, not included in the technical corrections bill but likely to resurface, are provisions for sharing of excess assets between participants and the plan sponsor, and the elimination of reversions altogether.\textsuperscript{172}

C. The Employee Pension Protection Act of 1989

It did not take the 101st Congress long to follow up on previous failures to limit reversions. On April 4, 1989, Senator Howard Metzenbaum (D. Ohio) introduced legislation designated S. 685\textsuperscript{173} and Representative Bill Clay (D. Mo.) introduced H.R. 1661;\textsuperscript{174} both bills were designed to severely restrict reversions.\textsuperscript{175} S. 685, typical of the restrictive bills, had three purposes:

First, to protect workers' fair share of the money set aside for retirement. Second, to encourage employers who terminate plans to set up new plans, as generous as their former ones. Finally, by fairly protecting workers' pensions, to reduce the incentive to use pension assets to finance a merger or takeover.\textsuperscript{176}

The approach here is similar to termination/reestabishment. In ei-
ther case, the amount of the reversion is dependent on the similarity of the new plan established by the employer with the terminated plan. In general, the bill provided that upon termination of the plan, if the employer adopted an identical plan, the new plan must retain a 125% cushion beyond projected plan liabilities and provide for a one-time increase to retirees. After meeting these two requirements, the employer may take any excess as a reversion. 177 Of course, since a plan termination is involved, all benefits must become 100% vested.

If an employer adopts a subsequent plan, but not an identical plan, any reversion that may be taken would depend on whether the new plan 178 is considered a substantial replacement plan, or a sham plan (a sham plan includes the situation in which no substitute plan is adopted). 179 If only a substantial replacement plan is established, the asset cushion is increased to 135%. The rationale behind the increased cushion is to protect against future market downturn and to compensate participants for additional loss of retirement benefits caused by the employer’s failure to adopt an identical plan. The substantial replacement plan must also give retirees a one-time increase in benefits. Only after all these requirements are met may the employer take any remaining assets as a reversion. 180

If the employer adopts a sham plan or no subsequent plan at all, the bill would require allocation of the 135% cushion to active participants, a one-time increase in retirees’ benefits, and then, pro rata allocation of any remaining assets to active participants. 181

Both the Senate and House versions of the reversion legislation died in the budget reconciliation process. However, with much of the preliminary work completed, and with the possibility that Congress will have more time on its hands next session, it is very likely that this same reversion legislation will be introduced. Its passage is a good possibility.

178. See supra note 113 and accompanying text.
179. It is somewhat odd that an employer’s voluntary adoption of a substitute plan would be considered a sham. If benefits are actually provided, this new plan is obviously real and beneficial.
D. It is Time for a Pension Policy

In light of the recent legislative changes and the voluminous transcripts from congressional hearings and studies, legislators should take additional time to consider the effects of current and proposed modifications and carefully weigh the pros and cons of any additional reversion related legislation. Further ad hoc legislation can only damage the pension system. Congress must design a cohesive and comprehensive policy regarding all future legislation in this area. This policy should follow the general outlines established in ERISA, with such modifications as are necessary based on experience since ERISA's adoption. The policy should look not only to promoting the health of the system, but also to the interests of plan participants and sponsoring employers. Once established, Congress must use its legislative powers only in furtherance of the unified policy, practicing what it preaches, by protecting the benefit security interests of plan participants and encouraging employers to establish and responsibly fund defined benefit plans. In this way, the private pension system will continue to thrive. Continued congressional ad hoc legislation will eventually spell the death of the defined benefit system and strike a serious blow to the retirement security of millions of workers.

While reviewing the results of its recent legislation and contemplating a national pension policy, Congress must consider the drastic consequences of further reversion legislation on the private pension system. Such consequences are analyzed in Part IV.

IV. Analysis of Why Current Legislative Direction Should Be Changed

During this time of reflection, Congress should think twice about a legislative direction which would change the current plan reversion system. Elimination or severe restriction of reversions is both mistaken and illogical. Before making any drastic changes regarding reversions, Congress must first look at the effects of such legislation upon the group it seeks to protect, the plan participants. The par-

182. Congress has failed to establish such a policy. It can be argued that the current legislative direction in Congress, toward further pension legislation, flies directly in the face of ERISA policy by taking away the incentives necessary for employers to adopt retirement plans. See infra notes 204-13 and accompanying text (reversion legislation violates the ERISA policy of promoting adequate funding).

Additionally, any policy should consider the positions taken by the governmental agencies overseeing the pension area. The PBGC, Department of Labor, and IRS all agree that reversion legislation would do more harm than good. Congress should listen carefully to these opinions since Congress placed those agencies in charge of overseeing the system.

183. Any legislation which would do away with reversions must be based on the rationale of further protecting participants' benefit security.
ticipants are the ultimate losers if there is any drastic modification of the current system. First, legislation limiting reversions will likely cause future defined benefit plans to be underfunded. Second, underfunding will likely increase the deficit of the PBGC. Both of these results adversely affect the benefit security of plan participants.

In addition to the participants' interests, Congress must consider the effects of legislation on the private pension system, specifically as it relates to defined benefit plans. Reversion legislation will have drastic effects on the current system. First, such legislation would destroy the nature of defined benefit pension plans. Second, reversion legislation flies in the face of important ERISA policies. Third, reversion legislation punishes many for the alleged abuses of a few.184

A. Underfunding will be the Likely Result

Defined benefit plan underfunding is a likely result of legislation eliminating or modifying plan sponsors' options185 to revert excess assets.186 Employers who adopt a plan to pay participants an expressly stated benefit at retirement may be unwilling to use a funding method and actuarial assumptions that result in excess funding. This is because a sponsoring employer adopts a plan to fund a specific benefit at retirement, not whatever benefit may be available depending on the trust's investment return.187 Additionally, since the employer bears the risk of investment losses, participants get the best of both worlds: a guaranteed benefit based on the plan formula plus

184. The following analysis applies equally to legislation which would totally eliminate an employer's option to revert excess funds, as well as the "sharing" approach which S. 685 shows is now in vogue.

185. Even with a valid provision in the plan document, the plan sponsor may decide not to take a reversion and to allocate excess assets among the participants. This is especially true with smaller plans when the plan sponsor is also a plan participant and wishes to distribute the excess to increase her own benefits as well as the other participants' benefits. See supra notes 82-85 and accompanying text (plan requirements for taking reversions).

186. PBGC Proposal Hearing, supra note 12, at 250 (testimony of Peter M. Kelly, Chamber of Commerce of the United States) ("To the extent that reversions are restricted... the result will unquestionably be less generous funding to the detriment of plan participants."); see also ASPA, supra note 66.

187. Indeed, the whole defined benefit system is designed to provide a "definitely determinable benefit." This benefit is expressly stated in the plan document, is calculated through involved specific accrual and vesting provisions, is to be paid on a determinable date, and is funded in such a way as to create enough money in the trust to pay the exact benefit at normal retirement. Forcing the plan sponsor to give up any excess changes this rigid system of benefits. See supra notes 136-43 and accompanying text; see also Subcommittee, supra note 1, at 36-39 (statement of David M. Walker, CPA, Assistant Sect'y for Pension and Welfare Benefits, U.S. Dep't of Labor).
a bonus if the employer funds the plan well. This is beyond the benefit promise the employer originally made.\footnote{188} Thus, a change in the law eliminating reversions is likely to force plan sponsors to use funding techniques which are less likely to create an excess. These assumptions, combined with a downturn in a trust's investment return, may lead to underfunding.\footnote{188}

Additionally, underfunded plans hurt plan participants. Even though the participants' benefits may be guaranteed by the PBGC,\footnote{189} this guarantee does not cover all plan benefits.\footnote{191} In addition, not all defined benefit plans are covered by the PBGC.\footnote{192} Furthermore, the PBGC guaranteed benefits are capped at a specific monthly amount,\footnote{183} and the PBGC only guarantees those benefits which were nonforfeitable prior to the plan's termination.\footnote{194} Thus, if the PBGC steps in, plan participants may lose valuable benefits they would have realized in a well-funded plan.\footnote{195}

### B. Increasing the PBGC Deficit

The PBGC now has a four billion dollar deficit caused by obligations to underfunded plans.\footnote{196} If future defined benefit plans are un-

\footnote{188}{See \textit{PBGC Proposal Hearing}, \textit{supra} note 12, at 249 (testimony of Peter M. Kelly, Chamber of Commerce of the United States) ("Employers will simply not commit themselves to a one-sided deal in which the rules are 'heads we win and tails you lose.'")}

\footnote{189}{Just as overfunding can occur through the use of conservative actuarial assumptions or better than anticipated investment experience, the use of liberal assumptions or a downturn in investment performance may cause the opposite result.}

\footnote{190}{The benefit guarantees by the PBGC insurance program are listed in \textit{ERISA} § 4022, 29 U.S.C. § 1322 (1982 & Supp. 1988).}

\footnote{191}{Generally, only benefits that were nonforfeitable prior to plan termination are guaranteed by the PBGC. \textit{ERISA} § 4022(a), (b), 29 U.S.C. § 1322(a), (b) (1982 & Supp. 1988). The maximum guaranteed monthly benefit for 1989 was $2,028.41.}

\footnote{192}{Plans which are not covered by the PBGC include: (1) individual account plans (defined contribution plans); (2) government plans or plans established under the Railroad Retirements Act of 1935 or 1937; (3) church plans; (4) a plan which is established solely for substantial owners as defined in \textit{ERISA} § 4022(b)(6); and (5) plans established by a professional service employer and which plan does not have more than 25 participants. \textit{See \textit{ERISA} § 4021(b), 29 U.S.C. § 1320(b) (1982).}}

\footnote{193}{\textit{See supra} note 191.}

\footnote{194}{A defined benefit plan must vest all benefits 100% at plan termination; however, the PBGC's guarantees only cover those benefits that were vested prior to termination. \textit{ERISA} § 4022(a), 29 U.S.C. § 1322(a) (1982).}

\footnote{195}{The participant could lose the difference between the vested benefit prior to plan termination (covered by the PBGC up to the annual maximum) and the fully vested benefit the participant would receive under a well-funded plan. For example, a participant whose monthly benefit before plan termination was $100 per month and who was 50% vested, would receive a maximum of $50 per month if the PBGC had to pay under its guarantees. A well-funded plan would pay the participant the fully vested benefit of $100 per month (of course, a partially underfunded plan may pay the participant a benefit somewhere between the PBGC benefit and the well-funded benefit).}

\footnote{196}{\textit{Subcommittee}, \textit{supra} note 1, at 64 (testimony of Kathleen P. Utgoff, Execu-}
derfunded, this deficit will rise substantially. Even more damaging is
the prospect that employers, scared away by the change in the rever-
sion laws, will be reluctant to adopt defined benefit plans.\textsuperscript{197} The re-
result of underfunded and fewer defined benefit plans is a decrease in
the benefit premiums received by the PBGC.\textsuperscript{198} In turn, this will re-
duce the PBGC's ability to depend on premium payments of well-
funded plans as a means of keeping the system afloat.\textsuperscript{199} This loss in
revenue will result in an even greater deficit.\textsuperscript{200} The potential finale
of this scenario is, without a government bailout, the collapse of the
PBGC insurance program.\textsuperscript{201}

In the end, the participant loses when the PBGC deficit increases.
The very basis of the PBGC guarantee is on the line; if the PBGC
goes belly up, participants' benefits go with it.\textsuperscript{202} The potential for
this occurring has already been seen to be real.\textsuperscript{203} To forestall such a
possibility, premiums for PBGC coverage have increased twice in the

tive Director, PBGC).

\textsuperscript{197.} \textit{Id.} at 66 (testimony of Kathleen P. Utgoff, Executive Director, PBGC) ("To
do so would discourage responsible employers from establishing and maintaining the pen-
sion plans that provide the best retirement security."). A recent report indicated that the
number of defined benefit plans currently in existence has dropped. \textit{See 16 Pens. Rep.}
(BNA) 2018 (Dec. 11, 1989) (outlining the results of the 1989 Hay/Huggins Benefit
Report). The constantly changing rules covering the defined benefit plan may have much
to do with this decline. Reversion legislation will increase the decline in defined benefit
plans.

\textsuperscript{198.} \textit{Subcommittee, supra} note 1, at 66 (statement of Kathleen P. Utgoff, Execu-
tive Director, PBGC) ("Any changes in the law to require sponsors to share reversions
with participants could create the wrong funding incentives which could further threaten
PBGC's financial security.").

\textsuperscript{199.} \textit{PBGC Proposal Hearing, supra} note 12, at 6 (statement of Kathleen P.
Utgoff, Executive Director, PBGC).

\textsuperscript{200.} \textit{Id.} at 7 ("At some point, the responsible companies may decide that their
premium dollars can be used better elsewhere. They may replace their defined benefit
pension plans with other arrangements. When companies with well funded plans leave
the program, the premium burden will rest on fewer and fewer shoulders. . . .")

\textsuperscript{201.} \textit{Id.} Congress would be forced to inject new strength into the system since the
recent method of attempting to bolster the sagging revenues of the PBGC, premium
increases, would result in premiums so enormously high that they drive away potential
sponsors.

\textsuperscript{202.} A prime example of the great value and necessity of the PBGC is the case of
the LTV termination. LTV terminated its plan which was grossly underfunded. The
PBGC stepped in and covered the benefits guaranteed under the program (doubling its
deficit). Without this insurance, thousands of participants' benefits would have been
practically worthless. Thus, the system does work to protect participants' benefits, but
only to the extent that it can stay financially healthy. If the pension termination system
ceased to exist, millions of participants would have to rely solely on the adequacy of the
sponsor's funding efforts for benefit security.

\textsuperscript{203.} \textit{PBGC Proposal Hearing, supra} note 12, at 5-10 (statement of Kathleen P.
Utgoff, Executive Director, PBGC); see \textit{supra} notes 196-201 and accompanying text.
last few years. In addition, a variable rate premium system has been implemented for high risk plans. However, the PBGC is in no way out of danger. The deficit continues, and the revenue base is still dependent upon well-funded plans. It is feared that another round of premium increases will turn employers away from defined benefit plans due to prohibitive premium payments. Concern is also voiced over any measure that would cause large numbers of plans to terminate. Large numbers of terminations, as with premium increases, reduce the number of plans contributing to the system, thus reducing revenue. An increase in the number of underfunded plans could thus place great stress on the benefit insurance system, potentially causing its collapse. The collapse of the PBGC insurance system would be a huge blow to the retirement benefit security of millions of plan participants. The potential combination of widespread plan underfunding and a collapse of the PBGC system would wreak havoc in the pension community, turning the clock back to pre-ERISA days.

C. Defined Benefit Plans Destroyed

Legislation eliminating reversions destroys the essential nature of a defined benefit plan. Benefits in the plan must be definitely determinable. That is, at any time, a participant's benefits can be accurately calculated. With reversion legislation, this requirement would be changed, and participants may have a claim to excess plan assets. Therefore, their benefits would not be based on the express language of the plan document, but on the value of the plan assets (similar to a defined contribution plan). This raises many ques-


205. PPA, § 9331(b), (c), (d), (e) (amending 29 U.S.C. §§ 1306(a)(3), 1307, 1305, 1306(c)(1)(A) (1982)).

206. See supra note 199 and accompanying text.

207. See supra note 157 and accompanying text.

208. See PBGC Proposal Hearing, supra note 12, at 15.


210. See supra notes 36-43 and accompanying text.

211. The essence of the definitely determinable benefit requirement is the ability to accurately calculate a participant's benefits at any time.

212. Indeed, the participant would have a benefit under the plan according to the plan document, but would also have a claim to the excess portion of plan assets. It is true that many employers allocate the excess assets after a termination to the participants. However, this is a voluntary action by the employer, not a mandatory one as it would be
tions. How is the plan to be administered? Does an individual participant who terminates employment receive a share of the excess? How is this excess to be distributed? Why would an employer adopt such a plan? Indeed, these questions and many others go to the heart of the defined benefit system.

It makes no sense to adopt legislation which would change the nature of the defined benefit plan. The current system has operated in the same basic manner for years. Benefits are expressly outlined and funded in accordance with accepted methods. The fact that plans are overfunded proves that this type of plan does provide the benefits that it promises. That many plans are overfunded proves that employers are keeping their promises. It is no wonder the defined benefit plan is the most popular form of pension plan today.213

However, with reversion legislation, the system changes. A system that has operated so well over time has the potential to become a system that is inefficient and risky. Employers will lose the incentives to properly fund their benefit promises (participants' benefits), will become dependent not only on the benefit expressly provided for in the plan but also on the performance of the trust, and will be placed at risk when a plan turns out to be underfunded.

D. ERISA Policy out the Window

ERISA strongly supports a policy of adequate funding of defined benefit plans.214 This policy is seen in the ERISA policy statement,215 the conference committee report,216 and implicitly in its es-

under a revised system. Under this type of system, the employer would probably adopt a defined contribution plan, or no plan at all.

213. PBGC Proposal Hearing, supra note 12, at 3 (statement of Chairman Pickle).

214. See supra note 209 and accompanying text; infra notes 215, 216 and accompanying text.

215. That despite the enormous growth of such plans many employees with long years of employment are losing anticipated retirement benefits. . . owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered; that owing to the termination of plans before requisite funds have been accumulated, employees and their beneficiaries have been deprived of anticipated benefits; and it is therefore desirable. . . that minimum standards be provided assuring the equitable character of such plans and their financial soundness.


tablished funding standards. A policy of adequate funding is also seen in ERISA provisions allowing an employer to take excess plan assets upon plan termination. Indeed, ERISA sought to avoid many of the troublesome problems and abuses of the past by insuring that the participants' benefits would be well funded. Moreover, this policy has worked! The vast majority of retirement plans are well funded; well funded in many cases means overfunded. The framers of ERISA understood this; they incorporated reversion provisions that had existed since 1938 because a policy which favors adequate funding necessarily recognizes overfunding. This protects participants' benefits. Upon termination, the participant must get 100% of his earned benefit; a well-funded plan supports this policy.

E. Punishing the Many

The PBGC program covers over 110,000 plans. Since 1980, 1897 plans have terminated with total reversions of around $20 billion. At first blush, this appears to be an enormous amount of money. However, in terms of the total trust values for all defined benefit pension plans, some $1 trillion, this number is quite small. Add to this the percentage of total plans which have terminated, and

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218. See PBGC Proposal Hearing, supra note 12, at 246-49 (testimony of Peter M. Kelly, Chamber of Commerce of the United States). Mr. Kelly traces the history of reversions from their origins in 1938 through ERISA and up to the present. He also indicates that there is a national policy furthered by allowing reversions.

219. See supra notes 216-17 and accompanying text.

220. See PBGC Proposal Hearing, supra note 12, at 250 (testimony of Peter M. Kelly, Chamber of Commerce of the United States) (“Actuarial science is an imprecise science. It is unlikely that an employer’s contributions when combined with fund experience will actually hit the precise funding target. This is particularly the case when a plan terminates.”).

221. See PBGC Proposal Hearing, supra note 12, at 247 (testimony of Peter M. Kelly, Chamber of Commerce of the United States). The conference committee also understood that a voluntary system needs incentives to induce potential plan sponsors to adopt defined benefit plans. See supra note 209.

222. See supra note 220. Since actuarial science is imprecise, erring on the side of overfunding protects the benefit security of plan participants.

223. See supra note 113 and accompanying text.

224. See PBGC Proposal Hearing, supra note 12, at 5 (statement of Kathleen P. Utgoff, Executive Director, PBGC).

225. Pension Protection Hearing 89, supra note 130 (the figures provided by the PBGC and the Department of the Treasury also indicate that 600 or so plans with terminations in excess of one million dollars were held up pursuant to the Treasury moratorium on determination letters).

226. Id. “[T]hese pension plans [defined benefit plans] have accumulated assets of nearly one trillion dollars, a sum which exceeds our national budget.”
it becomes clear that the reversion figure represents a small minority of plans covering a minority of plan participants. Additionally, statistics show that the number of plans terminating and taking reversions is down from prior years.

Legislation eliminating reversions would affect the vast majority of plans. Why should Congress punish the many for the actions of the few? The answer is simply, they should not. Legislation should focus on abuses and their correction, not on punishing sponsors who have not terminated their plans and who have adequately funded their plans.

Besides punishing the many employers who have not terminated their plans and taken reversions, why should plan sponsors be punished for prudent investment of the trust fund? A high rate of return for plan assets supports a policy of adequate funding. Yet, legislation disallowing reversions punishes the plan sponsor for properly funding the participants’ benefits through large investment returns. This result seems ludicrous if legislative policy is to benefit plan participants.

Having analyzed the drastic consequences of reversion legislation, it is evident that any modifications to the current system must be designed to preserve the status quo. Any proposal for change must take into account the interests of the participants, employers, ERISA policy, and the defined benefit system. Part V reviews prior proposals and presents a more workable solution.

227. The PBGC program alone covers over 30 million participants. \textit{PBGC Proposal Hearing, supra} note 12, at 5 (statement of Kathleen P. Utgoff, Executive Director, PBGC).

228. \textit{Pension Protection Hearing 89, supra} note 130. Statistics provided in the hearing present the following facts: In the period of 1980 through 1982, 126 plans terminated with reversions in excess of one million dollars; from 1983 through 1985, 1077 plans terminated; and from 1986 through 1988, 694 plans terminated. \emph{Id.; see also Subcommittee, supra} note 1 (testimony of Kathleen P. Utgoff, Executive Director, PBGC) ("From 1985 through 1987 there were about 28,000 plan terminations. Only four percent (1,100) of these 28,000 terminations involved reversions in excess of one million dollars. We have seen a substantial decline in the number of assets reversions, from a high of 584 in 1985 to 251 in 1987."); \textit{PBGC Proposal Hearing, supra} note 12, at 233 (statement of Richard H. Fay, Chamber of Commerce of the United States).

229. \textit{PBGC Proposal Hearing, supra} note 12, at 233 (statement of Richard H. Fay, Chamber of Commerce of the United States) ("Ironically, restrictions on reversions actually penalize those employers who have kept their pension promise by responsibly funding their plans.").

230. \textit{See supra} notes 66-73 and accompanying text.
V. PROPOSALS FOR CHANGE THAT PROTECT THE PARTICIPANT AND THE SYSTEM

Since the point of any legislation addressing the issue of reversions must be to benefit participants and to keep the defined benefit system healthy, doing away with reversions is not the answer. Instead, Congress should focus on avoiding the need to terminate plans in the first place. It is the plan termination which allows the reversion and, more importantly, the potential loss of participant benefit security.\(^{231}\) Thus, by avoiding or decreasing terminations, participants' benefits will continue to grow and the defined benefit system will continue to flourish.

A. Avoiding Termination

A primary concern about legislation making plan terminations more difficult is fear of the same problems inherent in reversion legislation.\(^{232}\) The overfunded plan still exists. Giving the participant some of the excess is not the answer either, since this solution will provide the wrong funding incentives to current plans and discourage the adoption of new plans. It must be recalled that the employer, in adopting a defined benefit plan, promises to pay a specific benefit to the participant, not to pay a congressionally mandated benefit increase if the employer succeeds in overfunding the plan. In order to avoid these pitfalls, it seems logical that a proposal allowing the plan sponsor to withdraw a portion of the excess funds without terminating the plan is desirable.

B. Prior Proposals

This type of proposal is not entirely new. The Reagan Administration submitted a proposal with this feature in 1987.\(^{233}\) Likewise, the American Society of Pension Actuaries (ASPA)\(^{234}\) submitted a similar proposal for dealing with the plan termination problem.\(^{235}\) Both

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231. As long as the plan stays in effect, the participant continues to accrue benefits. Upon termination of the plan, the participant's benefit accrual ceases. Thus, in order to protect participant benefits, the ideal solution is to promote the continuance of the plan. This means giving the sponsor incentives not to terminate the plan. Avoiding termination is the best solution to the problem; all parties can be satisfied by a carefully drafted solution.

232. Legislation making the termination of plans more difficult may be as detrimental as reversion legislation. The likely results of either legislation would be similar: plan underfunding, fewer defined benefit plans, and potential PBGC difficulties. See supra notes 185-230.


234. See supra note 67.

235. ASPA, supra note 66, at 9.
of these proposals attempt to avoid plan terminations, thus protecting participants' future benefits by keeping plans alive.\textsuperscript{236}

The proposals allow the employer to withdraw a portion of the excess assets from the trust without terminating the plan.\textsuperscript{237} It seems likely that an amendment would be necessary to the exclusive benefit rule to allow this withdrawal.\textsuperscript{238} Both proposals limit the amount of the withdrawal by placing a cushion between the accrued benefits of the participants and the amount of funds which remain after withdrawal.\textsuperscript{239} Other provisions provide safeguards for adequate funding after withdrawal,\textsuperscript{240} frequency of withdrawals,\textsuperscript{241} taxation of withdrawals,\textsuperscript{242} and subsequent termination of the plan.\textsuperscript{243} Thus, both the Administration and ASPA proposals provide a basis for participant benefit security and a healthy defined benefit plan industry by allowing the employer to access a portion of the excess assets while keeping the plan intact.

\textbf{C. A Better Proposal}

While the Reagan Administration's and ASPA's proposals are sensitive to the participants' needs, they do not deal with all issues important to participants. First, the proposal should include at least a twenty percent cushion between the participants' accrued benefits and the amount the employer may withdraw.\textsuperscript{244} This is necessary to insure adequate future funding and to insure that a drop in the trust's investment return will not place the plan in serious funding difficulty.\textsuperscript{245}

\textsuperscript{236} ADMIN. PROPOSAL, supra note 233, at 479 ("[t]he proposal permits employers to withdraw assets from ongoing defined benefit pension plans"); ASPA, supra note 66, at 10.

\textsuperscript{237} ADMIN. PROPOSAL, supra note 233, at 479; ASPA, supra note 66, at 10.

\textsuperscript{238} See supra notes 79-81 and accompanying text. This modification would have to provide for limited withdrawal as an additional exception to the exclusive benefit rule.

\textsuperscript{239} ADMIN. PROPOSAL, supra note 233, at 485; ASPA, supra note 66, at 10.

\textsuperscript{240} ASPA, supra note 66, at 12-14.

\textsuperscript{241} ADMIN. PROPOSAL, supra note 233, at 486.

\textsuperscript{242} Id. at 487.

\textsuperscript{243} Id. at 485.

\textsuperscript{244} The 20\% cushion between the participant's accrued benefits and the total trust assets would help to insure that the plan would not become underfunded due to the use of more liberal funding assumptions or because of a downturn in trust investment return. One of the goals of this proposal is to keep the plan intact while also continuing to promote responsible funding of defined benefit plans. The 20\% cushion helps promote that end.

\textsuperscript{245} See supra notes 132-43 and accompanying text. Without the asset cushion, the same complaints could be lodged against the plan as were made regarding spinoff/terminations and termination/reestabishments. It must be noted that this asset cushion
Second, consideration should be given to fully vesting the participants' benefits upon employer withdrawal of excess assets.\textsuperscript{246} Employers should not be able to withdraw excess funds without providing participants with some additional benefit security triggered by the withdrawal.\textsuperscript{247}

Third, as suggested in the Reagan Administration's proposal,\textsuperscript{248} limits should be placed on how often the employer may withdraw excess funds from the plan. The purpose of this proposal is not to create, for the employer, a new method to receive excess pension funds as they continue to build in the trust. Thus, the sponsor must be limited in the frequency of withdrawal.

Fourth, the excise tax on these withdrawals should be reduced, or eliminated. The present excise tax on reversions\textsuperscript{249} was implemented to deter the withdrawal of excess assets along with reducing the tax-advantaged gain (i.e., tax free accumulation of assets) in the assets while in the trust.\textsuperscript{260} While these same rationales continue to exist for the taxing of reversions, the increased security of participants and of the pension system is reason enough to reduce this tax to, at most, the old ten percent level.\textsuperscript{261}

Finally, modifications to ERISA and IRC provisions addressing plan terminations are required in order to address the needs of those plan sponsors who do need to terminate their plans. A system which allows a plan sponsor to withdraw excess assets without termination of the plan must still provide for those instances in which complete termination is needed. Consideration should be given to creating some type of business necessity test for complete plan terminations. Under this test, the IRS, PBGC, or both, would be required to re-

\textsuperscript{246} Neither the Administration Proposal nor the ASPA proposal provide the participant with full vesting upon asset withdrawal. However, full vesting of participants' benefits should be a requirement of any program which will allow the employer to withdraw assets from an ongoing plan.

\textsuperscript{247} Mandating 100\% vesting for all participants in the event of a withdrawal would place the participants in the same position they would have been in if the plan was terminated, spun off, or replaced. \textit{See supra} notes 113, 146.

\textsuperscript{248} Admin. Proposal, \textit{supra} note 233, at 486.

\textsuperscript{249} \textit{See supra} note 163 and accompanying text.

\textsuperscript{250} Kladler, \textit{supra} note 153, at 7. \textit{See also} PBGC Proposal Hearings, \textit{supra} note 12, at 392 (testimony of The American Society of Pension Actuaries) ("The rationale underlying the 10\% [amended to 15\%] excise tax is that it appropriately reverses the tax expenditure of sheltering investment return.")

\textsuperscript{251} The repeal of the excise tax would be preferable; however, it is unrealistic in light of the current desire in Congress to find revenue. \textit{See 17} Pens. Rep. (BNA) 157 (Jan. 15, 1990) (statement of a Senate Finance Committee aide who indicated that pensions are the place to raise revenues); \textit{see also} 16 Pens. Rep. (BNA) 2119 (Dec. 18, 1989) (discussing a recent GAO report that indicates that the 15\% excise tax of reversions is not sufficient to recapture the portion of the reversion that resulted from favorable tax treatment).
view the sponsor's request for termination with an eye toward the sponsor's business.

Although not perfect, this proposal makes all concerned better off. Most importantly, participants' benefits remain secure by keeping the plans in operation. The cushion between the accrued benefit and the remaining assets provides some assurances of adequate future funding, thus promoting an important ERISA policy. The defined benefit system itself is secured by keeping plans in existence and by no major alterations being made to the current system. Additionally, the PBGC becomes healthy and secure through an adequate revenue base and well-funded plans. Finally, the plan sponsor is content since a portion of the excess assets may be withdrawn from the plan to meet whatever needs the sponsor sees fit. Thus, this proposal allows all sides to reap some benefits without the drastic downsides that would result from legislation removing reversions.

CONCLUSION

Current law allows the sponsor of a terminated defined benefit plan to take excess plan assets after all plan liabilities have been satisfied. A heated debate is taking place in Congress and in pension industry circles regarding the wisdom of continuing this policy. Proponents of changing the current system claim excess assets should be distributed to plan participants. Opponents of reversion legislation cite ERISA policy, among other things, to support their contentions that the status quo should be maintained. After considering the unique nature of the defined benefit plan and the post-ERISA pension system, Congress should not pass any legislation which takes away, or places substantial constraints on, reversions. This conclusion is grounded in sound policy.

Legislating away reversions violates ERISA's policy of adequate funding. Underfunded plans reflect insecurity back on participants' benefits. Additionally, reversion legislation may place the PBGC insurance system in serious financial jeopardy. PBGC financial problems directly affect plan participants who count on it for benefit security. Furthermore, reversion legislation destroys the nature of the defined benefit plan and punishes many for the terminations of a very few. In the end, the party Congress seeks to assist with reversion legislation, the plan participant, is the party most seriously injured by the legislation.

A better answer lies in legislation which allows the employer, under specific circumstances and regulations, to withdraw a portion
of excess assets while the plan continues to operate. This legislation allows the employer to receive a reversion, the participant to continue to accrue future benefits, and does no harm to ERISA policies or the defined benefit system. In sum, all parties would be benefited, and the private pension system would “once again” thrive.

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