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PBGC and a FAILING PENSION

By Garrick G. Zielinski, CFP, CDFA

Discovery, analysis and evaluation should be completed before the negotiation and drafting begins.

The $354 billion pension problem! Changes in accounting for retiree benefits could mean harder times ahead even for health plans. Those were headlines this week at CNN/Money.com

The PBGC estimates that the approximate 32,000 defined benefit pension plans in the United States are under-funded by more than $450 billion. The largest portion, plans with $50 million or more in assets, are under-funded by more than $353 billion.

As you've learned about valuing pension plans for divorce, the largest problem is that the underlying assumptions used by the employer to fund the plan, are based upon future events. These are future events that cannot be predicted with much certainty. The assumptions include future interest rates, rates of return, life expectancy, and the actual retirement date of the employee. These assumptions become a chain of assumptions all supported by the weakest link. These are assumptions that are not routinely used within acceptable accounting standards, therefore there is disagreement as to which assumptions should be used and what should be applied to pension funding. Many plans are still feeling the effects of the 2000 through 2002 stock market bubble.

A major concern of Congress is if they create new funding policies, intended to shore-up the financially ailing pension plans, employer's will simply terminate the plan. In the early 80's, more than 180,000 defined benefit pension plans existed. Today that number has dwindled to about 32,000.

So what happens to a pension plan that is taken over by the PBGC?

The balance of this article will deal with two situations: (1) when PBGC becomes the trustee of a plan that is already in pay status pursuant to a QDRO and (2) when PBGC becomes trustee of a plan that has an approved QDRO but payments under that QDRO will not begin until a future date. It's likely that the bulk of your cases will deal with a situation where PBGC takes over a pension after you have entered a QDRO and the company's plan administrator has already approved the QDRO.

When PBGC becomes trustee of a plan with a QDRO already approved and in place, the PBGC reviews the QDRO once again, to determine if anything verbiage in the QDRO makes the order un-qualified under their rules. If any issues arise, PBGC will communicate directly with participant and alternate payee.

Because PBGC guarantees (maximum $3,799 per month in 2005) may not cover a participant's full pension benefit, a participant's benefit in some cases may be reduced after PBGC takes over the plan. This may reduce benefits payable to one or both parties under the QDRO. PBGC will not treat the QDRO as nonqualified solely because benefits paid by PBGC require reduction of the participant's and/or alternate payee's benefits. PBGC will apply "their" reduction rules (assuming the QDRO is silent regarding the issue) in the same manner (pro rata) as it applies the reduction rule after PBGC becomes trustee. For example, if a QDRO awarded a fixed percentage of the participant's benefit to the alternate payee, the benefits payable to both participant and alternate payee would be reduced to reflect PBGC's guarantee limitations.

On the other hand, if a QDRO awarded a fixed dollar amount, the participant's benefit would be first reduced to reflect the PBGC guarantee limitations. The fixed dollar amount to the alternate payee would be reduced *only if the total decrease to be made exceeded the participant's benefit*. This approach may catch many attorneys and practitioners by surprise. Assume a QDRO awarded a dollar amount of $1000 per month to the alternate payee. Further assume that the participant had accrued a $2,000 monthly benefit as of the date of divorce. The PBGC took control of the plan and recalculated a maximum $1,200 per month benefit payable under the plan. The alternate would still receive $1000 and the participant, would receive the remaining $200. If a different result was intended, an amended QDRO will be required and it must state the appropriate manner of division.

PBGC guarantee limitations apply to QDRO's issued before PBGC becomes the trustee of the plan. However, benefits plan payment options (life only for example) have limitations applied to the alternate payee's benefit payments or elections under the plan only where the QDRO was qualified *after* trusteeship.