

3. whether the distribution is consistent with plan provisions; and

4. whether an annuity contract that provides for a cutback in Title IV guarantee levels could have been purchased from an insurance company (.10).

.05 PBGC Reg. § 4044.4(b).

.10 *Ibid.*

### ¶ 6684 Method of Allocation

The method for allocating plan assets to pay for plan benefits involves the assignment and valuation of benefits. While plan administrators generally must allocate plan assets under the following rules, they may also use any other procedures that lead to each participant or beneficiary receiving the same benefits he would otherwise receive (.05):

#### ● Assigning benefits

Initially, a plan administrator assigns the basic-type and nonbasic-type benefits payable for each participant in a terminated plan to one or more priority classes in accordance with the rules described at ¶ 6687—6702. Benefits derived from voluntary employee contributions are treated as benefits under a separate plan. The amount of benefits payable for each participant is determined as of the date of plan termination (.10).

#### ● Valuing benefits

The value of a participant's benefits assigned to each priority class is determined, as of the allocation date, in accordance with the PBGC provisions relating to valuing benefits in non-multiemployer plans (¶ 6714) (.15).

Benefits initially assigned to each priority class are computed by first determining all of a participant's benefit of the type assigned to that priority class, for example, basic type or nonbasic type. A participant's benefits of each type are then valued and reduced by the value of the same type of benefit properly assigned to a higher priority class (.20).

For example, a participant's priority class 4 benefit includes his total basic-type benefit that does not exceed the guarantee limitations (¶ 6696). Following this determination, the plan administrator deducts the amount of the participant's basic-type benefit previously assigned to priority classes 2 and 3, if any (.25).

The same procedure is generally followed for nonbasic-type benefits. However, a nonbasic-type benefit in priority class 2 does not reduce nonbasic-type benefits in lower priority classes since this nonbasic-type benefit does not duplicate benefits in lower priority classes. Also, benefits derived from voluntary employee contributions (priority class 1) are not to be included in nor subtracted from lower priority classes. A benefit assigned to any priority class may not be valued at less than zero (.30).

#### ● Allocation of assets to priority classes

Assets available to pay for plan benefits are allocated to each priority class in succession, beginning with priority class 1. If the plan has sufficient assets to pay for all benefits in a priority class, the remaining assets are then allocated to the next lower priority class. This process is repeated until all benefits in priority categories 1 through 6 are provided or until all available plan assets are allocated. Any assets remaining after satisfaction of all benefits in priority classes 1 through 6 may be distributed to the employer if certain requirements are met (¶ 6677) (.35).

#### ● Allocation of assets to benefits within priority classes

Except for priority class 5, if the plan assets available for allocation to any priority class are insufficient to pay for all benefits in that priority class, those assets

are distributed pro rata to the participants. Specifically, the insufficient assets are distributed among the participants according to the ratio that the value of each participant's benefit in that priority class bears to the total value of all benefits in that priority class (.40).

In the case of priority class 5, if the plan assets available for allocation to that priority class are insufficient to pay for all benefits in that class, the assets are allocated, first, to the value of each participant's nonforfeitable benefits that would be assigned under the priority class 5 rules after reduction for the value of benefits assigned to higher priority classes. Benefits are determined based only on the plan's provisions in effect at the beginning of the 5-year period immediately preceding the date of plan termination. Second, if assets available for allocation to priority class 5 are sufficient to fully satisfy the value of the above-mentioned benefits, any remaining assets must be allocated to the value of the benefit increase under the oldest amendment during the 5-year period and each succeeding amendment during the 5-year period. This allocation is required to continue until all plan assets available for allocation have been exhausted. If an amendment reduces benefits, amounts previously allocated to priority class 5 in excess of the reduced benefits must be reduced accordingly (.45).

● **Allocating assets to basic-type or nonbasic-type benefits within priority categories**

Assets allocated to a participant's benefit within each priority class must first be applied to pay for the participant's basic-type benefit assigned to that priority class. Then, any remaining assets within that priority class must be applied to pay for nonbasic-type benefits assigned to that class (.50).

If the assets allocable to a participant's basic-type benefit in all priority classes are insufficient to pay for all of the participant's guaranteed benefits, the assets allocated to that participant's benefit in priority class 4 are to be applied first to the guaranteed portion of the participant's benefit in that class. Any remaining assets allocated to that participant's benefit in priority class 4 must then be applied to the nonguaranteed portion of the participant's benefit (.55).

● **Allocation to established subclasses**

Nevertheless, a plan is permitted to provide subclass priorities (specifically based on age, length of service, or disability) within any priority class except priority classes 1 and 2, provided the subclasses conform to the anti-discrimination provisions of the Tax Code (.60).

.05 PBGC Reg. § 4044.10.

.35 PBGC Reg. § 4044.10(d).

.10 PBGC Reg. § 4044.10(b).

.40 PBGC Reg. § 4044.10(e).

.15 PBGC Reg. § 4044.10(c).

.45 *ibid.*

.20 *ibid.*

.50 PBGC Reg. § 4044.10(f).

.25 *ibid.*

.55 *ibid.*

.30 *ibid.*

.60 PBGC Reg. § 4044.10(g).

¶ **6687 Priority Class 1 Benefits**

As indicated at ¶ 6675, the first priority class includes participants' accrued benefits derived from voluntary employee contributions. The benefit assigned to priority class 1 for each participant is the balance of the separate account maintained for the participant's voluntary contribution (.05).

¶ **6687**

However, if a participant has elected to receive an annuity instead of his or her account balance, the benefit assigned to priority class 1 for that participant is the present value of that annuity (.10).

.05 PBGC Reg. § 4044.11(b).

.10 *Ibid.*

### ¶ 6690 Priority Class 2 Benefits

The benefits in priority class 2 consist of participants' accrued benefits derived from mandatory employee contributions, whether they are to be paid as an annuity benefit with a pre-retirement death benefit or, if a participant so elects under the terms of the plan, as a lump-sum benefit (.05). Benefits are primarily basic-type benefits although nonbasic-type benefits may be included in priority class 2.

A participant's annuity and pre-retirement death benefit derived from mandatory employee contributions are basic-type benefits. The nonbasic portion in priority class 2 is equal to the amount by which the value of a lump-sum benefit elected in lieu of the basic-type benefits exceeds the value of the basic-type benefits (.10).

#### ● Contributions converted to an annuity benefit

A participant's accumulated mandatory employee contributions are to be converted to an annuity benefit payable at the normal retirement age or, if the plan provides for early retirement, at the expected retirement age, using the plan's interest rates and conversion factors (.15). In the absence of plan interest rates and factors, the IRS rates and factors in effect on the date of plan termination are to be used. In any event, the accrued benefit may not be less than the minimum nonforfeitable benefit required under Code Sec. 411(c) and ERISA Sec. 204(c).

For these purposes, the amount of the accumulated mandatory employee contributions for each participant generally is the participant's total nonforfeitable mandatory employee contributions remaining in the plan on the date of plan termination plus interest, if any, under the plan provisions (.20).

#### ● Assigning benefits

If a participant elects to receive an annuity and pre-retirement death benefits derived from his mandatory employee contributions, those benefits are assigned to priority class 2 (.25). The annuity benefit is the benefit converted from the participant's mandatory employee contributions as described above. The pre-retirement death benefit is the benefit under the plan that returns all or a portion of the participant's mandatory employee contributions upon the death of the participant before retirement. The combined value of the annuity benefit and the pre-retirement benefit is the participant's basic-type benefit in priority class 2.

If the participant elects under the plan to receive a lump-sum benefit that returns his mandatory employee contributions in lieu of the annuity and death benefits derived from those contributions, the benefit assigned to priority class 2 is the lump-sum benefit (.30). The lump-sum benefit is the excess of the accumulated mandatory employee contributions over the combined value of the annuity and death benefits. If the total amount of a participant's accumulated mandatory contributions is less than the combined value of the annuity and death benefits, the lump-sum benefit is limited to the total amount of the accumulated mandatory employee contributions. For purposes of computing the lump-sum benefit, the accumulated mandatory employee contributions means the contributions with interest payable to the participant or beneficiary on termination of the plan or, absent such provisions, the amount that is payable if the participant withdrew his or her contributions on the date of plan

termination. The lump-sum benefit is the participant's nonbasic-type benefit in priority class 2.

The pre-retirement death benefit and the lump-sum benefit may not be less than the minimum lump sum determined under Code Sec. 411(c) and ERISA Sec. 204(c) (.35). These sections provide that the lump sum may not be less than the actuarial equivalent of the participant's minimum accrued benefit derived from mandatory employee contributions (.40).

.05 PBGC Reg. § 4044.12(a).

.10 PBGC Reg. §§ 4044.12(a)(1) and (2).

.15 PBGC Reg. § 4044.12(b).

.20 PBGC Reg. § 4044.12(b)(1).

.25 PBGC Reg. § 4044.12(c)(1).

.30 PBGC Reg. § 4044.12(c)(2).

.35 PBGC Reg. §§ 4044.12(c)(1)(ii) and (c)(2)(iii).

.40 See IRS Reg. § 1.411(c)-1. For examples of methods for determining the actuarial equivalent, including an example of a reasonable approximation method, see Rev. Rul. 78-202, 1978-1 CB 124.

### ¶ 6693 Priority Class 3 Benefits

The benefits in priority class 3 include benefits that were in pay status before the beginning of the 3-year period ending on the date of plan termination (hereafter referred to as the "3-year period"), and those annuity benefits that could have been in pay status for participants who were eligible to receive them before the beginning of the 3-year period (.05). These benefits are principally basic-type benefits. However, nonbasic-type benefits will be included if any portion of a participant's priority class 3 benefits is not guaranteeable under the plan termination insurance provisions.

The determination of the benefit to be assigned to priority class 3 is a two-step process. The first step is to determine if a participant or beneficiary is eligible for a priority class 3 benefit. The second step is the calculation of the benefit amount.

#### ● First step: eligibility of participants or beneficiaries

A participant or beneficiary is eligible for a priority class 3 benefit if (.10):

1. the participant's (or beneficiary's) benefit was in pay status before the beginning of the 3-year period; or
2. the participant was eligible for an annuity and his benefit could have been in pay status before the beginning of the 3-year period (eligibility to receive an annuity before the beginning of the 3-year period is governed by the plan provisions in effect on the day before the beginning of the 3-year period).

Also, if a participant who is eligible to receive a priority class 3 benefit under (1) or (2) above dies within the 3-year period and the beneficiary is entitled to an annuity, the beneficiary is eligible for a priority class 3 benefit.

#### ● Second step: calculation of benefit amount

The annuity benefit that is assigned to priority class 3 for a participant is the lowest annuity that was paid or payable under the rules described below (.15).

**Plan provisions governing determination of benefit.** In determining the amount of the priority class 3 annuity for a participant, the plan administrator is to use the participant's age, service, actual or expected retirement age, and other relevant facts as of the following dates (.20).

**Participant in pay status.** For a participant whose priority class 3 benefit was in pay status before the beginning of the 3-year period, the priority class 3 benefit is determined according to plan provisions in effect on the date the benefit commenced. Benefit increases that became effective before the beginning of the 5-year period ending on the date of plan termination (the "5-year period"), including automatic

benefit increases after that date to the extent provided in (4) below, are to be included in determining the priority class 3 benefit (.25).

**Participant not in pay status.** For a participant who was eligible to receive an annuity before the beginning of the 3-year period but whose benefit was not in pay status, the priority class 3 benefit and the normal form of annuity are to be determined according to the plan provisions in effect on the day before the beginning of the 3-year period as if the benefit had commenced at that time (.30).

**General benefit limitations.** With respect to a participant whose benefit was in pay status before the beginning of the 3-year period, the benefit assigned to priority class 3 for such a participant is limited to the lesser of the lowest annuity benefit in pay status during the 3-year period, or the lowest annuity payable under the plan provisions at any time during the 5-year period (.35).

For a participant who could have been, but was not, in pay status before the 3-year period, the benefit is limited to the lowest annuity benefit payable under plan provisions in effect during the 5-year period, including any reduction for early retirement (.40).

If a plan is less than five years old on the date of plan termination, the lowest benefit in effect during the 5-year period is zero and the plan, therefore, has no priority class 3 benefits (.45).

**Determining beneficiary's benefit.** The benefit assigned to priority class 3 for a beneficiary who is eligible for such a benefit because of the death of a participant during the 3-year period will be determined as if the participant had died the day before the 3-year period began (.50).

**Automatic benefit increases.** If plan amendments adopted and effective before the beginning of the 5-year period provided for automatic increases in the benefit formula for both active participants and those in pay status or for participants in pay status only, the lowest annuity benefit payable during the 5-year period determined under (2) above should include automatic benefit increases scheduled during the fourth and fifth years, but not the first, second and third years, preceding plan termination. Automatic benefit increases are to be disregarded to the extent that the increase is greater for active participants than for those in pay status (.55).

**Computation of time periods.** For purposes of determining priority class 3 benefits, a plan or an amendment is considered to be "in effect" on the later of the effective date or the adoption date of the plan or amendment (.60).

#### ● Effect of plan amendment

The amount of benefits payable under ERISA Sec. 4044(a)(3) (that is, priority class 3 benefits) is dependent on the plan provisions in effect during the five years preceding termination. The amount of the participant's benefit is the lowest benefit that was in effect during the five-year period. In calculating the amount of a benefit under ERISA Sec. 4044(a)(3), a plan amendment adopted during the five years preceding plan termination that improves plan benefits would not be given effect (.65).

For example, assume a plan was amended to change the plan's eligibility requirements and increase the plan's benefits. If the amendment was adopted at least three, but less than five years before the plan's termination, the benefit payable under ERISA Sec. 4044(a)(3) would be affected. Even though a participant would be eligible to receive benefits under the amendment, the amount of benefits would not be the amount the amendment provided because such amount was not the lowest in effect during the five years preceding termination.

.05 PBGC Reg. § 4044.13(a). 10 PBGC Reg. §§ 4044.13(b)(2)-(6)

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| .15 PBGC Reg. § 4044.13(b)(1).     | .45 PBGC Reg. § 4044.13(b)(3)(iii). |
| .20 PBGC Reg. § 4044.13(b)(2).     | .50 PBGC Reg. § 4044.13(b)(4).      |
| .25 PBGC Reg. § 4044.13(b)(2)(i).  | .55 PBGC Reg. § 4044.13(b)(5).      |
| .30 PBGC Reg. § 4044.13(b)(2)(ii). | .60 PBGC Reg. § 4044.13(b)(6).      |
| .35 PBGC Reg. § 4044.13(b)(3)(i).  | .65 PBGC Opinion Letter 79-8.       |
| .40 PBGC Reg. § 4044.13(b)(3)(ii). |                                     |

#### ¶ 6696 Priority Class 4 Benefits

The benefits in priority class 4 consist of participants' basic-type benefits that do not exceed the guarantee limits (.05). However, the benefit assigned to priority class 4 for a participant is not limited by the aggregate benefit limitations for individuals who are participants in more than one plan or by the phase-in limitation applicable to substantial owners. See ¶ 6534 for further discussion of guaranteed benefit limits.

.05 PBGC Reg. § 4044.14.

#### ¶ 6699 Priority Class 5 Benefits

The benefits assigned to priority class 5 for each participant consist of all of the participant's nonforfeitable benefits under the plan (.05).

.05 PBGC Reg. § 4044.15.

#### ¶ 6702 Priority Class 6 Benefits

Finally, priority class 6 benefits for each participant include the remainder of the participant's benefits under the plan, whether forfeitable or nonforfeitable (.05).

.05 PBGC Reg. § 4044.16.

#### ¶ 6705 Allocation of Excess Assets Attributable to Employee Contributions

ERISA specifies the method by which an employer must allocate the amount of excess assets recovered from a terminated plan that is attributable to employee contributions. Where a reversion of excess assets is permitted, the portion of the remaining assets (after all liabilities have been satisfied) that is attributable to employee contributions is determined under the following formula (.05):

$$\text{Market value of total remaining assets} \times \frac{\text{Present value of accrued benefits attributable to mandatory employee contributions under priority class 2 (\text{¶ 6690})}}{\text{Present value of benefits whose assets are allocated under priority classes 2 through 6 (\text{¶ 6690—6702})}}$$

The result is then allocated among participants, beneficiaries, alternate payees under qualified domestic relations orders, and persons who received total distribution of plan benefits during the three-year period before plan termination, based on the amount of employee contributions to which they are entitled (.10).

#### CCH POINTER

*Plan must terminate before assets may be distributed to employees.* Plan assets attributable to employee contributions that remain after all liabilities of the plan to participants and their beneficiaries have been satisfied must be equitably distributed to the employees who made such contributions, in the event the plan actually terminates. However, the United States Supreme Court has ruled that, where the amendment of a contributory defined