Pension Benefit Guaranty Corporation

76-37

March 15, 1976

REFERENCE:
[*1] 4022(a) Benefits Guaranteed. Type of Benefits Guaranteed
4022(b)(1) & (8) Benefits Guaranteed. Five Year Phase-in of Guarantee.

OPINION:

This is in further response to your letter to * * * in which you ask why the Pension Benefit Guaranty Corporation (PBGC) is unable to protect your pension income completely. The plan involved is the * * * (the Plan).

The Employee Retirement Income Security Act of 1974 (ERISA), which established PBGC, sets forth certain limitations regarding the amount and type of benefits which we may guarantee.

One limitation under ERISA is that the amount that can be guaranteed with respect to a benefit increase in effect less than five years prior to plan termination must be phased in during a period not exceeding five years. For each year of such phase-in, 20% or $20.00 of the benefit increase, whichever is greater, may be guaranteed. Under the Plan, benefit increases were implemented within the five-year period prior to termination, and therefore this phase-in rule would be applicable to your benefit.

In addition, under the basic insurance program established by ERISA, only "pension" benefits are guaranteed. The Plan provides an additional supplemental benefit [*2] until age 65. This is not a pension benefit that can be guaranteed by PBGC.

While there are other limitations on the guaranteeable benefits under ERISA, the two discussed above are the ones that require an adjustment in the amount of your benefit. Inasmuch as these limitations are based on statutory requirements, PBGC has no discretion to exceed these limits.

The five-year phase-in limitation on guaranteed benefits, applying both to newly-adopted plans and to amendments to existing plans, was designed to reduce the risk of abuse of ERISA's guarantee provisions -- to guard against attempts to raise benefit levels substantially in anticipation of a pension plan's termination. For example, an employer with limited net worth, and thus limited liability to the PBGC upon plan termination, in contemplation of such a termination might otherwise be willing, because of pressure from participants or their collective bargaining representative or for the employer's own motives, to increase substantially the value of plan benefits, in order to increase the level of guaranteed benefits upon termination.

As indicated by the U.S. Senate Committee on Finance in a report recommending an earlier [*3] version of the Act, limitations were placed on the insurance coverage "because the insurance is not intended as a full replacement of a pension plan, but rather as covering the basic retirement benefits provided under it." One advantage of this limitation, according to that report, is that it "encourages those receiving the larger benefits [under pension plans], and who often are in a management position, to see to it that there is adequate funding of the pension plan."

In establishing insurance limitations Congress was concerned about the cost of the insurance program. While bank insurance is based on a specific amount actually deposited in a bank account, ERISA insures pension benefits which have not been funded. Thus, while the provisions of the Act require plan sponsors to meet specified minimum funding standards, and thus be better able to fund their promised benefits, the plan termination insurance program is not entirely comparable to that of the bank deposit insurance programs.

If you would like to discuss this matter further, please feel free to call us, either at (202) 254-4817 for our Office of Communications or on * * *

Kenneth L. Houck
Executive Director