Dealing with PBGC: A Practical Guide

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Overview

- A Brief Introduction to PBGC
- PBGC Premiums: Practical Tips
- Reportable Events
  - Traps for the Unwary
  - Transitioning to the New Rules
- ERISA Section 4010 Reporting
- Early Warning Program Negotiations
- PBGC Pursuit of "Downsizing Liability"

Overview (Cont.)

- Standard Terminations
  - Planning a Standard Termination
  - Standard Termination Procedures—Doing it Right
  - Standard Termination Distributions—Doing it Right
  - Surviving a PBGC Standard Termination Audit
- Distress Terminations
- Involuntary Terminations
- Bankruptcy Claims and Disputes

A Brief Introduction to PBGC

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- PBGC structure/governance/oversight
  - Government corporation
  - Board of Directors: Cabinet-Level Secretaries
    - Labor (Chair of Board)
    - Treasury
    - Commerce
  - Day-to-day: Run by Director (advice/consent position)

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A Brief Introduction to PBGC (Cont.)

- PBGC structure/governance/oversight (cont.)
  - Political oversight
    - Congress
      - House: Ways/Means and Education/Workforce Committees
      - Senate: Finance and HELP Committees
      - GAO
    - Executive Branch
      - Departments of Labor, Treasury, Commerce
      - OMB

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A Brief Introduction to PBGC (Cont.)

- PBGC funding
  - No “full faith and credit”
  - No tax dollars
  - Funded by:
    - Premiums paid by employers/plans
    - Assets in PBGC-trusteed plans
    - Recoveries from employers
    - Investment returns

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A Brief Introduction to PBGC (Cont.)

- Termination of PBGC-covered plans
  - Title IV of ERISA allows only:
    - Standard termination (fully-funded)
    - Distress termination (underfunded)
    - Involuntary (PBGC-initiated) termination (underfunded)

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A Brief Introduction to PBGC (Cont.)

- Termination of PBGC-covered plans (cont.)
  - Underfunded termination consequences for participants
    - *Will* receive guaranteed benefits
    - *May* receive some/all non-guaranteed benefits
    - Most participants' benefits are fully guaranteed
    - For many participants, key loss is lump sum option

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A Brief Introduction to PBGC (Cont.)

- Termination of PBGC-covered plans (cont.)
  - Underfunded termination consequences for employer
    - Employer liability for underfunding for *all* benefits (guaranteed and non-guaranteed)
    - Calculated using conservative PBGC assumptions (insurance industry annuity pricing)
    - *Each* member of sponsor's controlled group jointly and severally liable for *full* amount of:
      - Employer liability
      - Unpaid contributions
      - Unpaid premiums and new "termination premium" ($1,250 per participant, per year, for 3 years)

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A Brief Introduction to PBGC (Cont.)

- Termination of PBGC-covered plans (cont.)
  - Underfunded termination consequences for PBGC
    - Becomes successor trustee of plan
    - Pays guaranteed and (generally) at least some non-guaranteed benefits
    - Typically incurs loss based on underfunding and collects little/nothing on claims against employer
    - 4062(e) liability offers PBGC ability to protect itself before bankruptcy filing/plan termination

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A Brief Introduction to PBGC (Cont.)

- PBGC monitoring/reporting
  - Reportable events
  - Annual employer reporting
  - "Early Warning" ("Risk Mitigation") Program
    - PBGC monitors corporate transactions
    - Key PBGC threat: involuntary termination
  - Reporting of ERISA Section 4062(e) events

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PBGC Premiums: Practical Pointers

Flat-Rate Premium

- Unique PBGC definition of “participant”
  - Count *only* if plan has benefit liabilities (“earning” alone is not enough)
  - Drop after one-year break in service under plan rules
  - Drop based on “irrevocable commitment” once liability transfers to insurer (*before* certificate is issued)
- So always distinguish between plan “participant” and PBGC premium “participant”!

Flat-Rate Premium (Cont.)

- Don't just use Form 5500 participant count, which may include:
  - Participants with no benefit liabilities (*e.g.*, permanent part-timers)
  - Participants beyond plan break-in service period (up to 5 consecutive 1-year breaks)
  - Participants with irrevocable commitments but no certificates
  - Participants counted as of date other than flat-rate participant count date

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Flat-Rate Premium (Cont.)

- Use "deemed cashouts" of terminated non-vested participants to reduce participant count
  - Watch out for timing of deemed cashouts near EOY
  - Watch out for timing of "real" cashouts to avoid PBGC challenge to timing of "deemed" cashouts
  - Amend plan to make clear that employment termination date is cashout date

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Flat-Rate Premium (Cont.)

- For "real" cashouts and consensual lump sums:
  - May be able to drop even if payment is *after* participant count date, provided that
    - Annuity starting date on/before participant count date
    - Only "reasonable administrative delay" in payment
  - Encourage prompt payment to avoid annuity starting date arguments

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Flat-Rate Premium (Cont.)

- Consider carve-outs of certain participant groups through irrevocable commitments (cost factors)
- Drop "unlocatable" participant if "reasonable belief" of no living participant/beneficiary entitled to benefits
- Avoid paying flat-rate premium for small part of benefit
  - *Problem:* plan purchases irrevocable commitment for retiree benefits but grants ad hoc COLA payable from plan assets
  - *Solution:* purchase irrevocable commitment for COLA before participant count date

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Flat-Rate Premium (Cont.)

- Don't pay twice for the same participant!
  - If employee transfers from Plan A to Plan B, consider putting *entire* benefit in Plan B
  - Be sure to pay once for deceased participant, even if multiple beneficiaries are entitled to benefits
  - Ditto re participant and alternate payee — pay once!

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Flat-Rate Premium (Cont.)

- Note new flat-rate "termination premium"
  - Added by DRA
  - PPA made permanent
- Amount: $1,250 per participant per year (3 years)!
- Applies (generally) for post-2005 termination dates in PBGC-initiated or non-liquidation distress termination
- *Oneida* 2nd Circuit: survives reorganization intact
- May lead to more asset sales, fewer reorganizations

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Variable-Rate Premium

- Consider designating 8½ month “grace-period” contributions to prior year
  - Goal: reduce UVBs and therefore VRP
  - Watch out for missed quarterlies
    - Need “cash-in-the-plan” credit balance!
    - Note IRS rule requiring election by quarterly due date to use credit balance for quarterlies!

Variable-Rate Premium (Cont.)

- If considering standard termination near UVB valuation date
  - VRP may still apply based on premium underfunding
  - Conditional VRP exemption available *if* proposed termination date is on or before UVB valuation date
  - Consider VRP exemption in setting proposed termination date

Variable-Rate Premium (Cont.)

- Disregard any non-vested benefits
  - Focus on whether entitlement met as of UVB valuation date
  - For example:
    - "30 & out" benefits don't count until 30 is reached (based on pre-PPA guidance)
    - Disability benefits don't count until the individual is disabled
    - Pre-retirement lump sum death benefits don't count until individual is deceased

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Variable-Rate Premium (Cont.)

- Caution: PBGC will *not* treat benefit as nonvested merely because:
  - Benefit not 411(d)(6)-protected and thus can be amended out of plan
  - Participant still alive where benefit is payable upon death as:
    - QPSA
    - Post-retirement survivor annuity
    - Return of mandatory employee contributions

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Variable-Rate Premium (Cont.)

- Disregard benefit attributable to “unlocatable” participant/beneficiary based on:
  - “Reasonable belief” of no living participant/beneficiary entitled to benefits, *or*
  - Forfeiture provision (even if participant counts for flat-rate!)
- Consider reflecting irrevocable commitments in funding (and therefore UVB) calculations

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Variable-Rate Premium (Cont.)

- Determining UVBs under post-PPA rules
  - Old choices are gone
    - Alternative calculation method
    - General rule “roll-forward” (1/1 of prior year)
    - General rule “roll-back” (1/1 of current year)
  - Key new choice:
    - Standard premium funding target, or
    - Alternative premium funding target

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Variable-Rate Premium (Cont.)

- Alternative differs from standard target in that:
  - 24-month averaging of interest rates applies
  - Full yield curve applies (if elected for funding)
  - "Applicable month" (vs. month before premium payment year begins) is used to select interest rate
  - 2008/2009 transition rule applies (except for new plans or where election not to use rule for funding)

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Variable-Rate Premium (Cont.)

- Election/revocation is irrevocable for 5 years (but only *after* first "alternative" election is made)
  - If "alternative" used in 2008 or 2009, cannot change in 2010
  - If "standard" used in 2008 and 2009, can keep/change in 2010
  - Deadline to elect/revoke: VRP deadline for plan year
- Make sure to check "Box 5" if electing alternative premium funding target!

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Variable-Rate Premium (Cont.)

- Caution re estimated VRP filings (100+ lives)!
  - VRP estimate due “10/15” of current plan year
  - True-up due “4/30” of following plan year
  - Estimate must be based on *final* assets or penalty relief may be lost (even if assets *understated*)!
  - Estimate must be based on *final* determination of “alternative” vs. “standard” premium funding target
  - Estimate is subject to PBGC audit

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Mergers and Spinoffs

- Duplicate and gap premiums
  - Duplicate premiums in all mid-year spinoffs
  - Duplicate/gap premiums in some mid-year mergers
    - Duplicate example: Plan B (with October 1 plan year) merges into calendar year Plan A on December 1
    - Gap example: Calendar year Plan A merges into Plan B (with October 1 plan year) on December 1
  - Choose date and surviving plan carefully!

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Mergers and Spinoffs (Cont.)

- Duplicate and gap premiums (cont.)
  - Refunds available for change in plan year duplication
  - But if change in plan year coincides with merger, PBGC will deny refund

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Premium Consequences: Reporting

- Premium determination can affect:
  - Various waivers and extensions for post-event reportable events (pending proposal would drop these)
  - $50M and 90% triggers for advance reportable events
- Advise client of premium-related reporting consequences resulting from contribution choice

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Premium Audits

- Keep those records for 6 years!
  - Tie flat-rate count to particular participants
  - Document VRP determinations (*e.g.*, asset valuations, actuarial worksheets)
  - Document reasons for:
    - Significant year-to-year changes
    - Significant differences from AVR, Form 5500
  - Keep "static" e-record for each year!
  - Note "clarified/strengthened" recordkeeping rules
- On "gray" areas, be prepared to challenge, request reconsideration, let courts decide

Premium Penalties

- Take advantage of 1%/5% penalty policy
  - Try to correct potential underpayments ASAP, *before* PBGC issues written notice, to get 1% rate
  - But if payment is mailed same day PBGC issues (*e.g.*, electronic or fax) notice, you still get 1% rate
- Penalty waiver requests:
  - No need to include penalty waiver request with late payment
  - Consult PBGC policy (appendix to Part 4007) for waiver standards

Premium Interest

- Interest on underpayments vs. overpayments
  - PBGC charges interest on underpayments
  - Pre-PPA: PBGC position was no authority to pay interest on overpayments
  - PPA authorizes PBGC to pay interest on overpayments (awaiting rulemaking)

Premium Billings and Collections

- Read those bills carefully
  - Multiple plan year bills may have multiple errors
  - Focus on penalty calculations and movement of charges and credits from one plan year to another
  - Prepare your own calculation based on review of premium filings and payments, then compare!

Premium Refund Claims

- Be sure to provide required "explanation"
- Watch out for 6-year statute of limitations!
  - PBGC generally treats request as timely if *filed with PBGC* before statute runs
  - But if PBGC ultimately disagrees that refund is owed, statute of limitations is available to PBGC as defense
  - PBGC tolling agreements may be unenforceable
  - Bottom line: make request *well before* statute runs, and be prepared to file suit *before* statute runs

PBGC Reportable Events

PBGC Reportable Events: Traps for the Unwary

- "Change in controlled group"
  - Covers merger of two entities within controlled group
  - Timing keyed to binding agreement, not closing
- "Active participant reduction"
  - May occur any day (not annual snapshot)
  - Need not occur based on discrete "event"
  - May need to report twice in same plan year
  - Event may occur on "1/1" without any reduction
  - 4062(e) event: waivers/extensions inapplicable to 4063(a) notice

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PBGC Reportable Events: Traps for the Unwary (Cont.)

- Transfers of benefit liabilities
  - Generous waiver (use PBGC "safe-harbor" assumptions)
  - But may still be reportable (per informal PBGC guidance) as active participant reduction!
- "Extraordinary dividend" reportable event
  - Does not match IRC definition
  - Captures significant value transfer to any other controlled group member (up, down, or sideways)

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PBGC Reportable Events: Transitioning to the New Rules

- Under existing rules
  - Various funding-based waivers
    - "No VRP" (standard termination-based waiver)
    - "$1M UVB" (under $1M in UVB on VRP basis)
    - "80% funded" (determined on VRP basis and often coupled with non-funding-related condition)
  - Reporting relief where event involves only
    - Foreign non-parent (waiver)
    - Foreign parent or foreign-linked entity (extension)

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PBGC Reportable Events: Transitioning to the New Rules (Cont.)

- Under existing rules (Cont.)
  - Many other event-specific waivers/extensions
    - Active participant reductions (small plan waiver; extensions where 4062(e) event unlikely)
    - Small plan waiver (Tech. Update 09-4) for missed quarterly contribution if not based on financial inability
    - Missed contribution waiver if paid within 30 days
    - Waiver for liquidation of *de minimis* controlled group member
  - Availability of optional forms calling for reduced initial information submission

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PBGC Reportable Events: Transitioning to the New Rules (Cont.)

- Under proposed rules (74 FR 61248, 11/23/09)
  - All funding-based waivers gone
  - All “foreign” waivers/extensions gone
  - All missed contribution waivers gone
  - Most other waivers/extensions gone
  - New reportable events where:
    - AFTAP certified or presumed to be < 60%
    - $10M+ 420(f) transfer or, after such a transfer, funded ratio falls below 120% during transfer period
  - Mandatory forms with more information required

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PBGC Reportable Events: Transitioning to the New Rules (Cont.)

- Bottom line under proposal: more reporting of more events by more plans/sponsors
- Concerns:
  - Incentive to fund to avoid 4043 reporting obligation gone (but other incentives, *e.g.*, 4010/436, remain)
  - Burden of reporting
  - Burden of monitoring throughout controlled group to know when to report
  - Potential effect of more non-waived reportable events on loan and other corporate agreements

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PBGC Reportable Events: Transitioning to the New Rules (Cont.)

- Relief pending issuance of final rule:
  - All existing waivers and extensions in regulation remain in effect
  - Technical Update waiver for small plans for missed quarterly contribution if not based on financial inability remains in effect
  - Technical Update ability to use “look-back” variable rate premium numbers for waivers and extensions remains in effect
  - Details: PBGC Technical Update 09-4

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ERISA Section 4010 Annual Reports

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ERISA Section 4010 Annual Reports

- ERISA Section 4010 report required if:
  - *One* controlled group plan's FTAP < 80%; *and*
  - Controlled group-wide underfunding > $15M
- Watch out for other reporting triggers (significant noncompliance, per PBGC):
  - Missed contributions total > $1M unless corrected within 10 days
  - Outstanding waivers > $1M unless fully repaid
- Note: PBGC regulations require you to report that you no longer need to report!

"Early Warning Program" Negotiations

“Early Warning Program” Negotiations

- “Early Warning Program”
  - Also called “Risk Mitigation Program”
  - Focus: increased risk resulting from corporate transaction
- PBGC staffing: financial analysts, actuaries, accountants, and attorneys
- Controlled group liability is key

“Early Warning Program” Negotiations (Cont.)

- Joint and several controlled group liability
  - Applies to:
    - Unpaid contributions and related excise taxes
    - Ongoing/termination premiums (and penalties/interest)
    - Plan termination liability (unfunded benefit liabilities)
    - Certain information penalties (ERISA Section 4071)
  - *Each* member liable for full amount
  - PBGC liens ($1M+ missed contributions; portion of termination liability) can reach all controlled group property
  - All controlled group members are considered in distress and PBGC-initiated terminations

"Early Warning Program" Negotiations (Cont.)

- PBGC concerns:
  - Breakup of controlled group (*e.g.*, sale of "crown jewel" subsidiary)
  - Transfer of plan to weaker controlled group
  - Movement of value between/among CG members
  - Highly leveraged transaction
- PBGC leverage
  - PBGC-initiated termination (the "nuclear" option)
  - "Evade or avoid" lawsuit

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"Early Warning Program" Negotiations (Cont.)

- Your leverage
  - Save jobs (political/public relations leverage)
  - Plan *will* continue (financial leverage)
- Consider contacting PBGC first (where contact is inevitable, it may be that the earlier, the better)
- Settlement possibilities include:
  - Additional contribution to plan
  - Retention of plan by strong seller
  - Guarantee by seller if future plan termination
  - Transfer to plan of security interest

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PBGC Pursuit of "Downsizing Liability"

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4062(e)—Statutory Language

One sentence, many questions:

"If an employer ceases operations at a facility in any location and, as a result of such cessation of operations, more than 20 percent of the total number of his employees who are participants under a plan established and maintained by him are separated from employment, the employer shall be treated with respect to that plan as if he were a substantial employer under a plan under which more than one employer makes contributions and the provisions of sections 4063, 4064, and 4065 shall apply."

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4062(e)—PBGC Enforcement

- Section 4062(e) "on the books" since 1974 but largely dormant for over 30 years
- Mid-2006: PBGC final rule contained "fix" for statutory liability formula problem
- Final rule set stage for enhanced PBGC enforcement
- April 2010 handout from PBGC Chief Counsel (submitted for ABA Tax Section May Meeting):

  "We have stepped up our activity in this area in the last few years and it has become an important part of our risk mitigation program. As of March 2010, the agency had negotiated over 30 settlements valued at over $575 million, protecting almost 65,000 participants."

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4062(e)—The Basics

- Trigger:
  - Cessation of operations at facility in any location; and
  - As result of cessation, over 20% of plan's active participants separated from employment
- Liability amount:
  - Determine PBGC termination liability (UBL) for full plan
  - Multiply by headcount reduction percentage
- Satisfy liability with escrow or "up to 150%" bond
  - If distress or PBGC-initiated termination within 5 years, escrowed funds or bond proceeds added to plan assets
  - Otherwise, bond cancelled or escrowed funds returned (*without* interest)

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4062(e)—Reporting

- Section 4043 (Form 10) notice of active participant reduction reportable event due within 30 days
  - Various waivers for (*e.g.*) small plans, well-funded plans
  - Various extensions (generally in non-4062(e) cases)
- Section 4063(a) notice due within 60 days
  - Unclear when 60-day period starts (*e.g.*, date of cessation, date 20% threshold crossed)
  - No exemptions based on size, funding, etc.
  - All reportable event waivers/extensions inapplicable

4062(e)—Reporting (Cont.)

- 4043 and 4063(a) requirements are independent of one another
- Either 4043 notice or 4063(a) notice may be due first
- Reasons for reductions are:
  - Relevant for 4063(a)
  - Not relevant (except for certain waiver/extension purposes) for 4043

4062(e)—Open Issues

- Many unresolved interpretive issues, including re:
  - Applicability to asset or stock sales
  - “Facility”
  - “Location”
  - “Operations”
  - “Cessation”
  - “Result of”
  - “Separated from employment”
- Resolution likely to be through PBGC settlement

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4062(e)—Settlements

- Settlement possibilities include
  - Additional contributions (with credit balance restrictions)—now and/or later
  - Waiver of existing credit balance
  - Security for plan/PBGC
  - Guarantee by foreign controlled group member

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Planning a Standard Termination

Standard Terminations: Planning

- Why is termination necessary/appropriate?
- Is plan projected to have sufficient assets to pay all benefit liabilities?
  - Consider sufficiency commitment from employer
  - Consider majority owner "alternative treatment"
  - Consider "freeze and wait" approach (until 2012 when PPA lump sum changes are fully phased in?)
- Any replacement plan(s)?

Standard Terminations: Planning (Cont.)

- Develop participant communication strategy
- Any CBA bar to termination?
- Determine who has "settlor" authority for decision, then document (*e.g.*, board resolution)
- Determine who has authority to act as plan administrator to implement termination

Standard Terminations: Planning (Cont.)

- Develop "schedule" for termination
  - Earliest/latest NOIT dates
  - Proposed termination date
  - Notice of plan benefits and election notices for participants & beneficiaries
  - IRS determination letter request and related notices
  - Form 500 filing with PBGC
  - Annuity bids
  - Earliest/latest distribution dates
- Assign tasks (with deadlines!) among actuary, attorney, plan administrator, etc.

Standard Terminations: Planning (Cont.)

- Determine which costs may/should be paid from plan assets
- Decide “end game” investment strategy (probably very conservative)
- Review/address any illiquid assets
- Consider how to deal with potential reversion

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Standard Terminations: Planning (Cont.)

- Determine need for plan amendments
  - Top priority: retain qualified status!
  - Add termination lump sum provision?
  - Eliminate ancillary benefits or other non-411(d)(6)-protected benefits?
  - Freeze benefit accruals as “fail-safe” in case termination not successfully completed?
  - Address formula for allocating any residual assets among participants?
  - Fix variable indices for cash balance plan!

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Standard Terminations: Planning (Cont.)

- Watch out for PBGC's rules on "post-termination amendments"!
  - PPA lump sum assumption amendments
    - May be adopted after termination date for *qualification* purposes (at least until end of 2009 PY)
    - But PBGC rules require adoption on/before termination date unless amendment preserves pre-PPA lump sum basis
  - Similar concerns re residual asset allocation formula, other non-411(d)(6)-protected benefits

Standard Terminations: Planning (Cont.)

- Watch out for "transitional" PPA lump sum issues
  - Example 1:
    - Plan is amended *on/before* pre-2008 termination date to shift to PPA assumptions for post-2007 distributions
    - Distributions (annuity starting dates) are in 2008
    - PBGC Technical Update 07-2: use pre-PPA assumptions!
  - Example 2:
    - Example: 2008 termination date and 2009 distribution
    - PBGC Technical Update 08-4: use 2009 phase-in rules (40% phase-in) and 2009 mortality

Standard Terminations: Planning (Cont.)

- Evaluate availability of data and time needed to determine all “benefit liabilities”
- Develop/update mailing list for all participants/beneficiaries
- Identify potential “missing participants” and start “diligent search” efforts

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Standard Terminations: Planning (Cont.)

- Consider starting to research options for selection of annuity provider
- Be careful re pre-standard termination irrevocable commitment purchases
  - PBGC audit initiative in effect since late 2006
  - Consider approaching PBGC in advance for case-specific guidance
  - PBGC guidance project underway (request for public comment issued 11/23/09, 74 FR 61074)

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Standard Termination Procedures: Doing it Right

Standard Terminations: Notice of Intent to Terminate

- Count carefully re 60-90 day period from proposed termination date back to NOIT issuance date
  - Exclude proposed termination date (“day zero”)
  - Include NOIT issuance date
  - If 60/90-day date falls within weekend/holiday period, may issue NOIT on day before/after weekend/holiday period
  - Remember to test for earliest *and* latest NOIT!

Standard Terminations: Notice of Intent to Terminate (Cont.)

- Need to *anticipate* who *will be* “affected party” as of *future* “proposed termination date”
  - Err on side of over-inclusion
  - But if you miss someone, PBGC’s “after-discovered affected parties” rules can save you
- Be careful re NOIT “freeze” information
  - PBGC less likely to nullify for defect if benefits were frozen irrespective of plan termination
  - Make clear if freeze is independent of termination

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Standard Terminations: Notice of Intent to Terminate (Cont.)

- No special required format, but best to use PBGC’s “model” in Form 500 package
- Additional information permitted
  - Must not be “misleading”
  - Helps implement communications strategy (reason for termination, process/timing, replacement plan, etc.)
- Remember that once *first* NOIT issued, plan subject to lump sum/irrevocable commitments limitations

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Standard Terminations: Notice of Plan Benefits

- Must *complete* issuance of NOPBs *before* filing Form 500 with PBGC
- Consider including election notices with NOPBs
  - May depend on expected timing of distributions
  - Note PPA 180-day notice/consent period gives more flexibility

Standard Terminations: Notice of Plan Benefits (Cont.)

- Determination of category (pay status, valid election or de minimis benefits, others not in pay status) may be unclear
  - Example: de minimis hinges on interest rate not yet known
  - May want to provide NOPB information for multiple categories
- If NOPB error discovered later, correct by election notice deadline to preserve possible “correction of errors” relief

Standard Terminations: IRS Determination Letter Request

- Not required, but usually advisable
  - May not be feasible if goal is to distribute shortly after PBGC review period
  - But no disqualification "protection" without DL and greater likelihood of IRS audit
  - Note: PBGC will *not* treat DL as determinative of whether all benefit liabilities have been properly paid for Title I and Title IV purposes

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Standard Terminations: IRS DL Request (Cont.)

- File DL request *before* filing Form 500 with PBGC (allows later distribution deadline)
- DL timing leads to potential loss of control over distribution timing (risk of new stability period)
- May need substantial updating given IRS's DL "cycle" system (suddenly all amendments needed!)
- Remember that IRS and PBGC post-termination amendment rules differ!

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Standard Terminations: Form 500 Filing

- Watch out for deadline
  - *No later than* 180th day after proposed termination date (exception for DL requests)
  - *No earlier than* completion of NOPB issuance
- May need documentation of sufficiency measures to certify to projected sufficiency
  - "Sufficiency commitment"
  - Majority owner "alternative treatment"

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Standard Terminations: Form 500 Filing (Cont.)

- If more time is needed (*e.g.*, to complete NOPB issuance or to address sufficiency):
  - Move the proposed termination date (subject to 90-day limit re *earliest* NOIT)
  - Request an extension
  - Start over ("61-day expedited" process)

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Standard Terminations: PBGC Review

- PBGC likely to respond to Form 500 filing within 2-3 weeks
  - Acknowledgment letter (good news!)
  - Notice of incomplete filing (can still correct)
  - Notice of noncompliance (bad news!)
- If no word from PBGC within month or so, call to make sure filing was received!
- Termination distributions prohibited until 61 days after date PBGC *received* Form 500 filing

Standard Terminations: Notice of Annuity Information

- Often included with NOIT, but required at least 45 days before distribution
- Must identify insurers from whom (or from among whom) you intend to purchase irrevocable commitments
  - OK to include list of insurers from whom you reasonably expect to solicit bids
  - But new 45-day notice is required if new insurer is to be used

Standard Terminations: Notice of Annuity Information (Cont.)

- Remember to give notice to all participants and beneficiaries except de minimis cashouts
  - This includes participants expected to elect, or who have elected, consensual lump sum
  - One purpose of notice is to help participants decide whether to elect lump sum
  - Even a participant who has elected a lump sum can change election (subject to limitations)

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Standard Termination Distributions: Doing it Right

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Standard Terminations: Distribution

- Must complete distribution by later of:
  - 180th day after end of PBGC review period for Form 500, or
  - 120th day after receipt of favorable DL (if valid DL request submitted by time Form 500 filed)
- May need extension *(e.g.*, because of illiquid assets, benefit dispute, data issues)
  - File request at least 15 days before deadline
  - PBGC will focus on length of delay and exercise of ordinary business care and prudence

Standard Terminations: Distribution (Cont.)

- Note deductibility issues re contribution to “top up” for standard termination distribution
  - Can deduct in year of termination amount necessary to be sufficient for all benefit liabilities
  - PPA ‘06 rules generally allow larger deductions (so may be no need to wait until year of termination)

Standard Terminations: Distribution (Cont.)

- Distribution must meet ERISA/IRC requirements
- Concerns re difficulty/cost re purchase of irrevocable commitment for (*e.g.*) $6K benefit
- If participant with (*e.g.*) $100K benefit neglects or refuses to return election forms (or cannot get spousal consent), *must* annuitize
- PPA "prohibited payment" restrictions do not apply to payments to carry out standard termination in accordance with applicable law
- Note PBGC guidance re "transitional" PPA lump sum issues (Technical Updates 07-3 and 08-4)

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Standard Terminations: Distribution (Cont.)

- Watch out for timing of lump sum distributions!
  - Key issue: "annuity starting date" vis-à-vis stability period (and resulting "lookback" month) changes!
  - PBGC regulations presume distribution date is ASD in "absence of evidence establishing" another ASD
  - But presumption may be overcome by use of "immediate" ASD pursuant to Treas. Reg. § 1.417(e)-1(b)(1)
  - Note that delays in payment beyond reasonable administrative delay may result in new/later ASD
  - Retroactive annuity starting dates: special concerns

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Standard Terminations: Post-Distribution Certification

- PDC statutorily due within *30* days after distribution is *completed*
- PBGC provides penalty relief until *90* days after distribution *deadline*
- Mark that 90th day on your calendar as soon as you know distribution deadline!
- But may want to file PDC sooner, not later
  - Likelihood of audit essentially same whenever you file PDC
  - But earlier PDC filing puts you in earlier audit pool, so that any audit takes place before memories/records harder to reconstruct

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Surviving a PBGC Standard Termination Audit

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Standard Terminations: Audits

- Selection of plans for audits
  - 100% audit rate for standard terminations with more than 300 participants
  - Random sampling of smaller terminations
  - PBGC may select plan for other reason (*e.g.*, complaint from participant)
  - “Clean” audit for a practitioner *does not* ensure no future audits for that practitioner

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Standard Terminations: Audits (Cont.)

- Timing of plan selection
  - PBGC selects from PDCs filed each quarter
  - To make cutoff, file PDC few days early
  - If PDC filed late, any audit will be late!
- Initial audit letter generally issued within 30 days after end of quarter

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Standard Terminations: Audits (Cont.)

- Initial audit letter requests information in 30 days:
  - Summary participant data (name, address, and distribution form, amount, and date)
  - Reconciliation (from termination to distribution date) of participant counts and assets
  - Plan and trust documents
  - Annuity contracts
  - CBA
  - Last actuarial report
  - IRS determination letter
  - Other information, including EA worksheet

Standard Terminations: Audits (Cont.)

- PBGC sampling
  - PBGC selects sample participants from listing
  - PBGC requests detailed information on sample
  - PBGC sends confirmation letters to sample participants
  - PBGC reviews sample (follows up with PA, EA, etc.)
- Initial determination by auditor
- Final decision by higher level at PBGC
- PBGC enforcement of audit findings (will file suit if necessary)

Standard Terminations: Audits (Cont.)

- Focus of audit is on benefit determination and distribution, not on procedures
- Most common error: lump sums too low
  - Wrong determination date for interest rate or for current age
  - Wrong retirement age assumption
  - Failure to use plan assumptions that require greater than minimum lump sums
  - Adoption of post-termination amendments re lump sum assumptions
  - Remedy: employer pays balance due plus reasonable interest

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Standard Terminations: Audits (Cont.)

- Errors re irrevocable commitments
  - Failure to include all benefit options
  - Failure to interpret/apply benefit formula correctly
  - Use of erroneous participant data
  - Failure to preserve “future” lump sum basis
  - Remedy: correct irrevocable commitments

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Standard Terminations: Audits (Cont.)

- Effect of favorable determination letter
  - DL (per PBGC) is *not* determinative of validity of termination
  - DL is *prima facie* evidence of Title I compliance
  - Notwithstanding favorable DL, PBGC will enforce its own findings re Title I requirements

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Distress Terminations

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Distress Terminations

- If plan is underfunded, only way to terminate voluntarily is through “distress termination”
- *Each* controlled group member must meet at least one test:
  - Distress Test 1: Liquidation in bankruptcy/insolvency
  - Distress Test 2: Reorganization in bankruptcy
  - Distress Test 3: Inability to continue in business
  - Distress Test 4: Unreasonably burdensome pension costs
- Each CG member may meet different test
- Distress terminations usually arise in bankruptcy setting (liquidation/reorganization)
- Collective Bargaining Agreement can block distress termination (subject to 1113 motion to reject CBA)

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Distress Terminations (Cont.)

- Liquidation distress test (Test 1): automatic
- Reorganization distress test (Test 2): often contested
  - Show “meaningful sacrifices” in all areas
  - Show plan unaffordable even w/freeze & waiver
  - If lender/investor insists on plan termination, show:
    - Lender/investor has sound financial basis
    - Inability to find lender/investor not insisting on termination
  - Multiple plans: PBGC argues for plan-by-plan determination
  - Watch out for any *non-debtor* controlled group members (each one must also meet distress!)
  - Watch out for “follow-on” replacement plans (major PBGC concerns!)

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Distress Terminations (Cont.)

- Distress permitted outside bankruptcy under Tests 3 and 4
  - PBGC makes determination
  - Can be very useful for small to mid-size employer where bankruptcy not otherwise necessary, too costly, etc.
  - Business continuation test (Test 3) analogous to reorganization test (Test 2)
  - Test 4 very rarely used to date
- Procedures
  - Various notices and filings
  - Restrictions on lump sums and annuity purchases
  - Cutbacks of benefits to estimated Title IV levels
  - No specific deadline for PBGC to decide distress

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Distress Terminations (Cont.)

- In (common) bankruptcy reorganization context, PBGC will
  - Appear in court
  - Submit brief stating its view of Test 2, and
  - Support, oppose, or take no position on distress motion
- Note PPA's "deemed" termination date of bankruptcy petition date
  - For certain purposes relating to Title IV benefit amounts
  - Not for employer liability

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PBGC-Initiated Terminations

PBGC-Initiated Terminations

- PBGC-initiated termination (“involuntary termination”)
  - May be used/threatened to block corporate transaction:
    - Breakup of controlled group (*e.g.*, sale of “crown jewel” subsidiary)
    - Transfer of plan to weaker controlled group
    - Movement of value between/among CG members
    - Highly leveraged transaction
  - May be used (in some circumstances) to cut off increased PBGC exposure (guaranteed benefits)

PBGC-Initiated Terminations (Cont.)

- PBGC-initiated termination (cont.)
  - Possible “triggers” include reportable event notices and “Early Warning Program” monitoring
  - Less controversial uses:
    - “Abandoned” plans
    - “Shortcut” in lieu of distress process
  - May be (and often is) done by agreement with plan administrator

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PBGC-Initiated Terminations (Cont.)

- Criteria for PBGC-initiated termination
  - Minimum funding standard not met (missed annual “catch-up,” not missed quarterlies)
  - Plan “will be unable” to pay benefits when due (*mandatory* termination if *currently* unable)
  - Substantial owner distribution (rare)
  - “Long-run loss”: “the possible long run loss of the [PBGC] with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated”
- “Long-run” loss analysis
  - Likelihood of future termination if PBGC does not act now
  - Expected increase in PBGC loss

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PBGC-Initiated Terminations (Cont.)

- PBGC can quickly set termination date by publishing notice
  - "Locks in" immediate termination date, related liability
  - But subject to later court approval or agreement with plan administrator
- Termination date
  - May be retroactive
  - But not before participant expectations extinguished
  - PBGC may seek later date for financial reasons
  - Subject to PPA's "deemed" termination date of bankruptcy petition date
    - For certain purposes relating to Title IV benefits
    - Not for employer liability
- CBA *cannot* block PBGC-initiated termination

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Bankruptcy Claims/Disputes

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Bankruptcy Claims/Disputes

- Key PBGC concerns
  - Adequate information in disclosure statement
  - Funding of plan during bankruptcy
  - Future of plan
    - Ongoing
    - Standard termination
    - Distress or PBGC-initiated termination
  - Treatment of PBGC claims
- PBGC bankruptcy claims
  - Many priority arguments raised by PBGC
  - Most arguments rejected by courts
  - Usually resolved with “global” PBGC settlement

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Bankruptcy Claims/Disputes (Cont.)

- Potential PBGC “post-bankruptcy” liability
  - New “exit fee” for PBGC-initiated terminations and non-liquidation distress terminations
    - $1,250 per participant, per year, for 3 years
    - For employers in bankruptcy reorganization, 3-year period starts post-confirmation
  - *Oneida* decision (survives reorganization intact)
  - If future case law follows *Oneida*, may lead to more asset sales followed by liquidations

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Bankruptcy Claims/Disputes (Cont.)

- Guarantor claims
  - Unpaid premiums
    - General unsecured if plan year starts pre-petition
    - Check PBGC calculation methodology!
  - "Unfunded Benefit Liabilities"
    - Contingent on plan termination
    - Often filed as unliquidated claim
    - Disputes re amount: based on PBGC valuation regulation assumptions (controversial)
    - Disputes re priority: PBGC may claim tax status (30% of aggregate positive CG net worth), but courts reject

Bankruptcy Claims/Disputes (Cont.)

- Successor trustee claims
  - Unpaid contributions
    - Contingent on plan termination and PBGC trusteeship
    - Tax status arguments ($1M+) rejected by courts
    - Post-petition "administrative" priority
      - Limited (at most) to normal cost
      - Reduce for decline in employment levels
    - Limited priority for 180-day pre-petition period
    - Rest is general unsecured
  - Fiduciary breach (not common)

Bankruptcy Claims/Disputes (Cont.)

- Resolving claims with PBGC
  - Settlement common
  - Actuary to actuary (plan/PBGC): agree on numbers
  - Attorney to attorney (debtor/PBGC): resolve priority and (for UBL claim) amount disputes
  - End result:
    - May be single sum
    - If PBGC sees good "test case," settlement may not happen

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Questions?

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