# A Practical Guide to Dealing with PBGC Issues

ASPPA Annual Conference
October 21, 2007 ● Washington, DC

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## Overview

- Premiums
  - Flat-rate and variable-rate premiums
  - Mergers, spinoffs, and duplicate/gap premiums
  - Reporting/disclosure consequences
  - Premium audits/enforcement
  - Premium refunds
  - Summary of recent statutory/regulatory changes
- Reporting, monitoring, and enforcement
  - Reporting requirements: "traps for the unwary"
  - Penalties and subpoenas

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## Overview (Cont.)

- Standard terminations
  - Planning
  - Procedures
  - Distribution and audit
- Distress terminations
- Involuntary terminations
- Bankruptcy claims and disputes
- On the horizon: PBGC's regulatory agenda

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# *PBGC Premiums: Practical Pointers*

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## 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)
  - Multiple beneficiaries of deceased participant = one participant
- So always distinguish between plan "participant" and PBGC premium "participant"!

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## 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
  - Several beneficiaries instead of one participant
  - Participants counted as of non-premium snapshot 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
- Pay out “real” cashouts and consensual lump sums near EOY promptly 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 where “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 premium snapshot 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, put *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 (distress or involuntary) if ongoing employer
- Being challenged in bankruptcy reorganization
- May lead to more asset sales, fewer reorganizations

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## Variable-Rate Premium

- Fund up to FFL exemption where cost-effective
  - Always factor in VRP savings in evaluating funding options
  - Exemption repealed after 2007 premium payment year (so already too late for calendar-year plans)
- Consider designating 8½ month "grace-period" contributions to prior year
  - Goal: reduce UVBs and/or meet FFL exemption
  - Watch out for missed quarterlies (need "cash-in-the-plan" credit balance)!
- Consider reflecting irrevocable commitments in funding (and therefore UVB) calculations

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## Variable-Rate Premium (Cont.)

- Take advantage of new PPA small employer relief from VRP (effective 2007)
- Eligibility: 25 or fewer *employees*
  - Controlled group aggregation applies
  - "Employee": use minimum coverage definition (PBGC proposal)
  - Count on first day of premium payment year

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## Variable-Rate Premium (Cont.)

- Small-employer VRP cap
  - Per-participant cap: $5 x *participant* count (in *plan*)
  - Plan-wide cap: $5 x *square of* participant count
  - Example: 20-participant plan cap = $2,000 (not $100!)
  - Count participants as of flat-rate snapshot date
- Note: eligibility tied to *employees* but cap tied to *participants*
  - 30-participant plan might be eligible
  - 20-participant plan might be ineligible

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## Variable-Rate Premium (Cont.)

- If considering standard termination near year-end
  - 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

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## Variable-Rate Premium (Cont.)

- Disregard any non-vested benefits
  - Focus on whether entitlement met as of premium snapshot date
    - “30 & out” benefits don’t count until 30 is reached!
    - Disability benefits don’t count until the individual is disabled!
  - Caution: non-411(d)(6)-protected benefits that can be amended out of plan
    - Note PBGC’s 2007 proposal to treat as vested if conditions met but benefit not yet amended out of plan
    - Unclear how proposed interpretation to apply to prior years

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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!)

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## Variable-Rate Premium (Cont.)

- Always run general rule *and* ACM (unless at $0 UVBs)!
- Factors affecting ACM vs. general rule results include:
  - Last year's events/trends (count for ACM only if "significant event" and large plan, but always count for general rule)
    - Poor "ordinary course" investment experience doesn't count!
    - No way to count *favorable* events/trends under ACM!
  - Effect of ACM's age 50 average age assumption
  - Effect of ACM's 7% accrual assumption
- Note PBGC's proposal to drop ACM starting in 2008!

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## Variable-Rate Premium (Cont.)

- Be careful with general rule "roll-forward" of *last year's* 1/1 valuation
  - PBGC guidance: must reflect experience gains/losses
  - May cover more than just "significant events"
- Note PBGC's proposal to drop 1/1 "roll-forward" starting in 2008!

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# Variable-Rate Premium (Cont.)

- Be careful with general rule *current year* 1/1 valuation option—back out 1-day material changes
  - Changes in methods (*e.g.*, AVA to FMV)
  - Changes in assumptions *(e.g.*, retirement decrements)
  - Changes in plan provisions, population, etc.
- Note PBGC's proposal for 2008 and later would obviate need for 1/1 valuation option!

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# Mergers and Spinoffs

- Duplicate and gap premiums
  - Duplicate premiums in all mid-year spinoffs
  - Duplicate premiums in some mid-year mergers
    - Example: Plan B (with October 1 plan year) merges into calendar year Plan A on December 1
  - Gaps in premiums in some mid-year mergers
    - Example: Calendar year Plan A merges into Plan B (with October 1 plan year) on December 1
  - Choose the date and the 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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## Mergers and Spinoffs (Cont.)

- Protect FFL exemption in mergers and spinoffs
  - PBGC guidance provides relief for certain BOY/EOY mergers/spinoffs by clarifying which “history” to use
  - No guidance for mid-year transactions
  - For 1/1 merger of calendar and fiscal year plan, treat calendar plan as survivor to fit within guidance
- Note PPA eliminates FFL exemption starting with 2008 premium payment year!

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## Premium Consequences: Reporting and Disclosure

- Premium determination can affect:
  - $50M *pre-PPA* gateway test under ERISA § 4010
  - VRP test for *pre-PPA* Participant Notice under ERISA § 4011
  - Various waivers and extensions under ERISA § 4043(a) (post-event reporting of reportable events)
  - $50M and 90% triggers under ERISA § 4043(b) (advance reporting of reportable events)
- Advise client of premium-related reporting/disclosure 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!
- On "gray" areas, be prepared to challenge, request reconsideration, let courts decide

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## 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!

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# Premium Refund Claims

- Be sure to provide required "explanation" (for refund claims of over $500)
- 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

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## Key Statutory Changes (DRA/PPA)

- Flat rate premium increased and inflation-indexed
- Termination premium introduced
- VRP
  - Liability based on funding target using special discount rate
  - Assets based on fair market value
  - FFL exemption eliminated
  - New VRP cap for plans maintained by small employers (25 or fewer employees)
- PBGC given authority to pay interest on premium overpayments

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## Key *Proposed* Regulatory Changes

- Implementation of 2006/2007 statutory changes (2/20/07 NPRM)
  - Flat-rate increase/indexing
  - Termination premium (clarifies applicability, liable entities, and due dates)
  - Small employer VRP cap (defines "employee")
- Implementation of 2008 statutory changes (5/31/07 NPRM)
  - Single "premium snapshot date replaced by "UVB Valuation Date" and "Participant Count Date"
  - UVB Valuation Date = funding valuation date (may be after 1/1 for small plans)

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## Key *Proposed* Regulatory Changes (Cont.)

- Implementation of 2008 statutory changes (5/31/07 NPRM) (cont.)
  - Determining assets/liabilities for small plans with non-1/1 valuation dates
    - Back out current year pre-valuation-date contributions (with interest)
    - Exclude current year accruals
  - Optional election (irrevocable for 5 years) to use funding rules ("alternative premium funding target")

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## Key *Proposed* Regulatory Changes (Cont.)

- Implementation of 2008 statutory changes (5/31/07 NPRM) (cont.)
  - Calculation flexibility eliminated (no ACM and no general rule "roll-forward")
  - Due date deferral for small plans (fewer than 100 participants for *prior* year)
    - Entire premium due last day of 16th calendar month beginning on/after 1st day of premium payment year
    - Example: April 30, 2009, for 2008 calendar-year small plan paying 2008 premium

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# Key *Proposed* Regulatory Changes (Cont.)

- Implementation of 2008 statutory changes (5/31/07 NPRM) (cont.)
  - Due date penalty relief for mid-size (100-499) and large (500+) plans (based on *prior* year participant count)
    - No change to VRP due date (*e.g.*, October 15, 2008, for 2008 premiums)
    - Penalty (but not interest) relief for "true-up" of VRP payment by small plan due date
    - Initial VRP payment must be based on *final* asset value and "reasonable estimate" of funding target
    - No change to flat-rate due date structure (including "safe-harbor" penalty relief for "estimated" payments for large plans)

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# Key *Proposed* Regulatory Changes (Cont.)

- Implementation of 2008 statutory changes (5/31/07 NPRM) (cont.)
  - Elimination of certain regulatory special rules & exemptions
    - FFL exemption (tracks statutory repeal)
    - Small well-funded plan rule (had waived reporting of UVBs based on actuarial certification of no UVBs)
    - Large plan accrued benefit rule (had permitted use of accrued rather than vested benefits for UVB calculation)
    - Funding interest rate rule (had permitted use of funding interest rate if lower than premium interest rate)

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## Key *Proposed* Regulatory Changes (Cont.)

- Implementation of 2008 statutory changes (5/31/07 NPRM) (cont.)
  - Interpretation of "vested" for UVB purposes (see Slide 15)
  - Recordkeeping/audit clarifications/strengthening
    - Broad interpretation of "records" to be retained
    - Requirement for "system" support
    - Establishment of "presumed" UVBs
    - Faster "on-site" record production
    - Faster record submission

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## *PBGC Reporting Requirements: "Traps for the Unwary"*

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## PBGC Reporting Requirements: Reportable Events — In General

- Post-event reporting: the challenges
  - Reporting required sporadically, not periodically
  - Event may relate to distant controlled group member
  - Rules not always “intuitive”
- Watch out for multiple plans in controlled group!
  - Particular reportable event may occur “for” two/more plans
  - Determine waivers, extensions, and required information *separately* for *each* plan for which event has occurred!

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## PBGC Reporting Requirements: Reportable Events — In General (Cont.)

- Watch out for multiple events!
  - Two/more events may arise at about same time out of same/related facts
  - Determine waivers, extensions, and required information *separately* for *each* event!
- Use “optional” Form 10 (significantly reduced initial information submission)

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## PBGC Reporting Requirements: Selected Reportable Events

- "Change in controlled group" reportable event
  - Covers plan transfer without *any* change in CG makeup
  - Timing keyed to binding agreement, not to closing
- "Active participant reduction" reportable event
  - Could occur *any day* of plan year (not an annual snapshot)
  - Need not occur based on discrete "event"
  - May need to report *twice* in same plan year

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## PBGC Reporting Requirements: Selected Reportable Events (Cont.)

- Transfers of benefit liabilities
  - Generous waiver (use PBGC "safe-harbor" assumptions)
  - But may still be reportable as active participant reduction!
- "Extraordinary dividend" reportable event
  - Does *not* match IRC definition
  - Captures significant value transfer to *any* CG member

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## PBGC Reporting Requirements: 4062(e) Events

- Trigger: cessation of "operations at a facility in any location" results in > 20% active participant reduction
- Many unresolved interpretive issues as to whether and when 4062(e) event occurs
- Reporting required under 4063(a) within 60 days
  - No exemptions based on size, funding level, etc.
  - 4063(a) reporting requirement independent of reportable event requirements (*e.g.*, active participant reduction)

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## PBGC Reporting Requirements: 4062(e) Events (Cont.)

- Significant financial consequences
  - PBGC may pursue liability to protect plan in case of distress/involuntary termination within 5 years
    - Amount: full termination liability (PBGC assumptions) times active participant % reduction
    - Form: escrow (100%) or bond (up to 150%)
  - If plan remains ongoing for 5 years, escrow returned or bond cancelled
  - Penalty exposure for late 4063(a) notice and/or late reportable event notice

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## PBGC Reporting Requirements: Form 200

- Statutory lien and Form 200 requirement triggered when missed contributions (with interest) > $1M
- Note PBGC's calculation methodology (see PBGC Opinion Letter 2001-1)!
  - Add up all missed/unpaid contributions (each with interest to current missed contribution date)
  - Total may significantly exceed accumulated funding deficiency (Op. Ltr. example: $1.2M vs. $630K)!
  - Smaller plans/employers may hit $1M before they know it!

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## PBGC Reporting Requirements: Form 200 (Cont.)

- Significant financial consequences
  - Statutory lien, loan defaults, etc.
  - Maximum penalty ($1,100 per day) likely for late Form 200
  - PBGC/creditor workout or bankruptcy

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## PBGC Reporting Requirements: Section 4010 Annual Reports

- Pre-PPA thresholds
  - – $50M aggregate UVBs test (most common trigger) affects larger plans/employers
  - – But some smaller plans/employers may hit:
    - $1M outstanding waiver threshold
    - $1M lien threshold (note PBGC methodology!)

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## PBGC Reporting Requirements: Section 4010 Annual Reports (Cont.)

- Post-PPA threshold
  - – $50M aggregate UVBs test replaced by one-plan FTAP < 80% test
  - – Could affect even smallest plans/employers!
  - – JCT Report calls for PBGC waivers in appropriate circumstances, “such as in the case of small plans”
- Note: PBGC regulations require you to report that you no longer need to report!

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## Penalties and Subpoenas

- Penalty exposure up to $1,100 *per day* for *each* person required to report or disclose
  - "Guideline" penalties generally much lower
    - $25 per day for first 90 days
    - $50 per day thereafter
    - Proportional reduction for plans with < 100 participants
    - Overall cap of $100 x participant count
  - But PBGC may assess larger penalty where warranted
  - PBGC normally assesses maximum penalty for Form 200 failures and *advance* reporting failures

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## Penalties and Subpoenas (Cont.)

- PBGC has discretion re whether to assess, how much to assess, and whether/how much to waive
- "Reasonable cause" waiver guidance in *proposed* policy statement issued in 2001
  - 2001 Blue Book guidance (Q&A 18): proposed guidance is "largely reflective of the PBGC's current practices"
  - Note: *no* relief based on claim that outside actuary or other advisor was responsible for the failure

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## Penalties and Subpoenas (Cont.)

- Penalty authority applies only where time limit is specified in certain statutory/regulatory provisions
- PBGC may subpoena information, whether or not it is subject to penalty authority
- Comply with PBGC information requests!

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## *Standard Terminations*

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## 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
- Any replacement plan(s)?
- Develop participant communication strategy
- Any CBA bar to termination?

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## Standard Terminations: Planning (Cont.)

- 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
- 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

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## Standard Terminations: Planning (Cont.)

- Assign tasks (with deadlines!) among actuary, attorney, plan administrator, etc.
- 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 index for cash balance plan!

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## Standard Terminations: Planning (Cont.)

- Determine need for plan amendments (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 plan year)
      - But PBGC rules effectively 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
  - Note pending issue re ability to rely on PPA amendment adopted before pre-2008 termination date for 2008 distributions!

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## 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
- Consider starting to research options for selection of annuity provider
- Be careful re pre-standard termination irrevocable commitment purchases (new PBGC audit initiative)!

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## Standard Terminations: Notice of Intent to Terminate

- 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
- Count days 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 both for earliest and latest NOIT!

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

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

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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 new 180-day notice/consent rule gives more flexibility
- 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

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## 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 that 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 Determination Letter 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* 180$^{th}$ 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

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## 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

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## 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 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

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## 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)

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## 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

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## Standard Terminations: Distribution (Cont.)

- Watch out for timing of lump sum distribution “annuity starting date” vis-à-vis stability period (and resulting “lookback” month) changes!
  - PBGC regulations presume distribution date is ASD “in the 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 is statutorily due within *30* days after distribution is *completed*
- PBGC provides penalty relief until *90* days after distribution *deadline*
- Mark that $90^{th}$ day on your calendar as soon as you know distribution deadline!
- But may want to file PDC sooner rather than 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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## 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

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## 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)

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## 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 distress test:
  - Distress Test One: Liquidation in bankruptcy/insolvency
  - Distress Test Two: Reorganization in bankruptcy
  - Distress Test Three: Inability to continue in business
  - Distress Test Four: Unreasonably burdensome pension costs

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## Distress Terminations (Cont.)

- Each member may meet different test
- Distress terminations usually arise in bankruptcy setting (liquidation/reorganization)
- Remember that CBA can block distress termination (subject to 1113 motion to reject CBA)

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## Distress Terminations (Cont.)

- Liquidation distress test: automatic (for liquidating member(s) of controlled group)
- Reorganization distress test: often contested
  - Show "meaningful sacrifices" in non-pension areas
  - Show plan unaffordable even with freeze and waiver
  - If lender/investor insists on plan termination,
    - Show sound financial basis for lender's/investor's position
    - Show inability to find lenders/investors not insisting on termination

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## Distress Terminations (Cont.)

- Reorganization distress test: often contested (cont.)
  - Multiple plans: PBGC argues for plan-by-plan determination of distress
  - Watch out for any *non-debtor* controlled group members (must each also meet distress!)
  - Watch out for "follow-on" plans (PBGC concerns!)
- Distress also permitted outside of bankruptcy under Tests 3 and 4
  - PBGC makes determination
  - Business continuation test (Test 3) analogous to reorganization test (Test 2)
  - Test 4 very rarely used to date

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## Distress Terminations (Cont.)

- Procedures
  - NOIT to participants, beneficiaries, and union
    - Similar to standard termination version
    - Must be issued at least 60 days and (except with PBGC approval) no more than 90 days before proposed termination date
  - First NOIT triggers restrictions on paying lump sums or purchasing irrevocable commitments
  - Possible restrictions even before NOIT (based on "anticipation of termination" rules)
  - Form 600 (NOIT to PBGC)
    - Relatively straightforward form
    - But need all information re controlled group makeup/structure

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## Distress Terminations (Cont.)

- Procedures (cont.)
  - – Proposed termination date triggers benefit cutbacks
  - – Form 601
    - Due 120 days after proposed termination date
    - Must include detailed information supporting distress test for each controlled group member
  - – No specific regulatory deadline for PBGC to decide whether distress is met

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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 (for guarantee, PC 3) tied to bankruptcy petition date

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## *Involuntary Terminations*

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# Involuntary Terminations

- Involuntary termination (initiated by PBGC)
  - May be used/threatened to block corporate transaction:
    - Sale of "crown jewel" subsidiary
    - Transfer of plan to weaker controlled group
    - Movement of value between/among CG members
    - Highly leveraged transaction
  - May also be used (in certain circumstances) to cut off increased PBGC exposure for guaranteed benefits
    - Impending shutdown benefits (less likely now given PPA change to phase-in rules)
    - Increase in maximum guarantee or phase-in

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## Involuntary Terminations (Cont.)

- Involuntary termination (initiated by PBGC) (cont.)
  - – Less controversial uses
    - "Abandoned" plans
    - "Shortcut" in lieu of distress process
  - – May be (and often is) done by agreement with plan administrator ("consensual involuntary")
- Possible "triggers" include reportable event notices and "early warning" program

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## Involuntary Terminations (Cont.)

- Criteria for involuntary 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)
  - – PBGC "long-run loss" determination:
    - "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"

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## Involuntary Terminations (Cont.)

- "Long-run" loss analysis
  - Likelihood of future termination if PBGC does not act now
  - Expected increase in PBGC loss (current v. future termination)
- Note that PBGC can act quickly to set termination date by publishing notice
  - Serves to "lock in" immediate termination date and related liability
  - But subject to later court approval or agreement with plan administrator

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## Involuntary Terminations (Cont.)

- Termination date
  - May be retroactive
  - No earlier than when participant expectations extinguished
  - PBGC may seek later date for financial reasons
  - Subject to PPA's "deemed" termination date (for guarantee, PC 3) tied to bankruptcy petition date
- Remember that CBA *cannot* block involuntary 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 involuntary termination
  - Treatment of PBGC claims

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## Bankruptcy Claims/Disputes (Cont.)

- PBGC bankruptcy claims
  - Many priority arguments raised by PBGC
  - Most arguments rejected by courts
  - Usually resolved with “global” PBGC settlement
- Potential PBGC “post-bankruptcy” claim
  - New “exit fee” for underfunded terminations with ongoing employers
    - $1,250 per participant, per year, for 3 years
    - For employers in bankruptcy reorganization, 3-year period starts post-confirmation
  - Being challenged in court
  - If upheld, 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
    - Disputes re amount: based on PBGC valuation regulation assumptions (controversial)
    - Disputes re priority: PBGC claims tax status up to 30% of aggregate positive net worth in CG, but courts have rejected

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## 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

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## Bankruptcy Claims/Disputes (Cont.)

- Successor trustee claims (Cont.)
  - Fiduciary breach (not common)
- 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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## *PBGC's Regulatory Agenda*

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## PBGC's Regulatory Agenda

- Issued April 30, 2007 (next agenda due shortly)
- Proposed rule stage
  - Reportable events (PPA changes to VRP)
  - Multiemployer regulations (withdrawal liability changes)
  - Missing participants program expansion (PPA authority)
  - ERISA section 4010 reporting (PPA changes)
  - 2008 premium changes (primarily PPA changes to VRP; published 5/07; now in final rule stage)
  - Disclosure of termination information (PPA changes)

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## PBGC's Regulatory Agenda (Cont.)

- Final rule stage: penalty policy (ERISA section 4071 information penalties)
- Long-term actions: valuation regulation
- Not yet on agenda: interest on premium overpayments

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## For Further Information . . . .


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