PBGC Potpourri: New Rules, Guidance, and Leadership

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AUTHORS: David Ashner, Katie Kohn, Michael Kreps, Louis Mazawey, Michael Prame

The Pension Benefit Guaranty Corporation ("PBGC") – one of three key regulators of private-sector defined benefit pension plans – has recently (1) released guidance on premiums and shutdown liability that could impact corporate transactions undertaken by plan sponsors; (2) requested OMB approval in seeking additional financial and actuarial information from sponsors in connection with notifying PBGC of certain reportable events; and (3) finalized changes to its rules regarding owner-participants. Additionally, PBGC may have a new director by year end. Below we discuss the latest from the federal pension insurer.

I. PBGC Premium & Reverse Spinoff Guidance

As summarized in our July 26, 2018 **Benefits Brief**, PBGC staff provided informal guidance on a practitioners' Q&A page on its website regarding the payment of premiums in the case of a two-step "reverse spinoff" transaction. A reverse spinoff is a transaction where a company that sponsors an underfunded plan ("Old Plan") creates a new plan ("New Plan") that is virtually identical to the Old Plan, but with a new name, EIN, and plan number. The company spins off most plan participants into the New Plan, leaving only a small group of retirees in the Old Plan. The company then terminates the Old Plan, generally by purchasing annuities. PBGC staff, citing the federal common law principle that substance should prevail over form, expressed skepticism about such transactions as a way to avoid paying PBGC variable-rate premiums and suggested that such transactions would not be eligible for the exemptions afforded to terminating and new plans under PBGC's regulations (29 C.F.R. § 4006.5(a)(3) and (f)(1)).

More recently, PBGC updated the 2018 comprehensive premium filing instructions, apparently intending to further limit the exemptions for the variable-rate premium. Under the prior instructions, PBGC stated that plans that terminate in a standard termination are exempt from the variable-rate premium if the plan "makes a final distribution of assets in a standard termination during the Premium

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Payment Year." However, in the new 2018 instructions, PBGC "clarified" that a plan qualifies for the standard termination exemption if "by year end, benefits for participants covered by the plan on the UVB Valuation Date [*i.e.*, the first day of the plan year] will be distributed in accordance with PBGC's standard termination regulation… and PBGC coverage of such benefits will cease." PBGC presumably intended to limit this exemption to exclude reverse spinoff transactions, given that not all benefits for participants covered by the plan on the UVB valuation date are distributed in these transactions.

The premium filing instructions are not the law, and PBGC staff guidance released on PBGC's website does not constitute rulemaking or official PBGC policy and thus is not binding. However, these updates further underscore PBGC's likely position with respect to reverse spinoff transactions. At this point, it is unclear whether and how PBGC will enforce premiums for terminating and new plans in relation to reverse spinoff transactions.

The new premium filing and reverse spinoff guidance is useful to plan sponsors weighing the risks of a reverse spinoff or other restructuring transactions. Flat-rate and variable-rate premiums can constitute significant expenses for plan sponsors, and if premiums are not timely paid, sponsors are subject to interest (currently 5%), which cannot be waived by PBGC, and penalties (2.5% per month), which may be waived by PBGC in certain circumstances. The addition of interest and penalties can place a significant and unexpected burden on plan sponsors.

II. Reportable Events

PBGC relies, in part, on employer reporting to identify transactions and corporate events that potentially present a risk to the pension insurance system or to plan participants. In particular, section 4043 of Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and the reportable event regulations (29 C.F.R. Part 4043) often require plan administrators and sponsors of defined benefit pension plans to notify PBGC where, for example, there are controlled group changes, active participant reductions, loan defaults, missed contributions of over $1 million, and transfers of benefit liabilities. Generally, reportable event filings must be made within 30 days after the event (unless waived altogether), but some plans are subject to an advance reporting requirement for certain events. Failure to timely report may result in a penalty of up to $2,140 per day, although PBGC generally reduces the penalty for most reportable events.

PBGC issued final **reportable event regulations** in 2015 to better target the plans and sponsors that pose these financial risks. The agency is now **proposing** that all reportable event filings include controlled group information, financial statements, and the plan's actuarial valuation report. That information is not currently required for five types of reportable event filings. Comments on the proposed reporting changes can be submitted through November 13, 2018.

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III. Facility Closure Guidance

In 2013, Congress significantly revamped the rules under ERISA section 4062(e) that govern pension liabilities in the event of certain facility closures. As summarized in our prior **Benefits Brief**, liability potentially arises under section 4062(e) when a "substantial cessation of operations" occurs, meaning that operations at a facility permanently cease, resulting in a workforce reduction of more than 15 percent of "eligible employees." PBGC has not issued regulations implementing the changes to the law. However, on October 12, 2018, the agency provided additional guidance in the form of **Frequently Asked Questions**. The new guidance mirrors the law by describing the circumstances that give rise to a 4062(e) event—a permanent cessation of operations at a facility that results in a workforce reduction of more than 15% of the total number of eligible employees—and explains that "eligible employees" include employees eligible to participate in any employee pension plan. PBGC then notes that it can take steps to protect a pension plan when a 4062(e) event occurs by requiring the employer provide protection for the pension plan.

IV. Changes to Owner-Participant Rules

On October 3, 2018, PBGC finalized its changes to special rules applicable to plan participants with certain ownership interests in their plan sponsors (called "owner-participants"). 83 Fed. Reg. 49799. The changes, which were originally proposed on March 7, 2018 (83 Fed. Reg. 9716), are intended to conform PBGC's regulations with certain legislative changes made by the Pension Protection Act of 2006 ("PPA 2006") and PBGC practices in the interim. PBGC's final rule mirrors its proposed rule, with two minor exceptions described below.

ERISA section 4022 imposes certain limitations on PBGC's guarantee of plan benefits. For owner-participants, prior to PPA 2006, PBGC's guaranteed benefits were phased in over a 30-year period (compared with 5 years for all other participants). In addition, the extent to which guaranteed benefits were phased in for each owner-participant was calculated individually based on the number of years he or she had been participating in the plan. For all other participants, guaranteed benefits were phased in based on the number of years that a plan provision that increases benefits was in effect prior to the plan's termination date.

PPA 2006 greatly simplified the process for calculating guaranteed benefits for owner-participants: first, the same five-year phase-in used for non-owners is applied; then, a separate "owner-participant limitation" is calculated based on the plan's age (regardless of whether the plan has increased benefits). Under PPA 2006, the phase-in period for the owner-participant limitation is 10 years. PBGC's final rule conforms its regulations to the PPA 2006 simplified approach. The final rule also clarifies that in the event of a PPA 2006 bankruptcy termination, the plan's age is equal to the length of time between the later of the plan's effective date or its adoption date, and the date of the bankruptcy filing (this clarification was not included in PBGC's proposed rule).

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ERISA section 4044 governs the method by which the assets of a terminated single-employer defined benefit plan must be allocated to its benefit liabilities. Section 4044 assigns all benefits to one of six "priority categories." Benefits affected by the owner-participant limitation under ERISA section 4022 are assigned to priority category 4 ("PC4"), along with certain other benefits. PPA 2006 updated the way that assets must be allocated within PC4 when the plan's assets are sufficient to cover some, but not all, PC4 benefits. Specifically, prior to PPA 2006, assets had to be allocated pro rata among the various types of PC4 benefits, including benefits affected by the owner-participant limitation. After PPA 2006, if the plan's assets are sufficient to cover some, but not all, PC4 benefits, assets can be allocated to benefits affected by the owner-participant limitation only if assets remain after being allocated to all other PC4 benefits. PBGC's final rule conforms its regulations to the PPA 2006 revised asset allocation requirements.

When a plan undergoes a distress termination, ERISA section 4041(c)(3)(D) requires the plan administrator to continue paying benefits. But commencing on the proposed termination date, such payments must be limited to the amount that PBGC is expected to pay once it becomes trustee of the terminated plan. This requirement means that until PBGC assumes control of the plan, sponsors must estimate and pay the amount of each participant's benefit guaranteed by PBGC, or, if greater, the amount funded by the plan's assets. PBGC's final rule updates the methods by which sponsors must estimate guaranteed benefits for owner-participants to reflect the changes made by PPA 2006, described above. However, PBGC did not change the method for estimating asset-funded benefits (despite the changes to PC4 allocation requirements described above), based on its determination that any potential overpayments to owner-participants would not reduce benefits paid to other participants because their asset-funded benefits are estimated under a higher priority category (PC3).

Finally, PBGC's proposed rule would have replaced the longstanding definition of "majority owner" under its single employer plan termination rules with the definition of "majority owner" added by PPA 2006 with respect to owner-participants. The key difference between the two definitions is that the longstanding definition includes, *inter alia*, anyone who owns 50 percent or more of an unincorporated trade or business, while the PPA 2006 definition does not apply to a less-than-100 percent owner of an unincorporated trade or business. Because PBGC ultimately determined that the changes made by PPA 2006 were not intended to apply for purposes of its single employer plan termination rules, it omitted this change from the final rule and left its longstanding definition in place.

V. PBGC Director Nomination

On May 15, 2018, President Trump nominated Gordon Hartogensis to replace Tom Reeder as the Director of PBGC. Mr. Hartogensis is currently a trustee for his family's trust and manages the trust's assets. His prior experience is largely related to technology and start-up companies. As reported by

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numerous media outlets, Mr. Hartogensis is brother-in-law to Senate Majority Leader Mitch McConnell (R-KY) and is married to the sister of Elaine Chao, current Transportation Secretary and former Secretary of Labor.

The Senate Finance Committee held a hearing on September 27, 2018, to consider Mr. Hartogensis' nomination. At the hearing, Mr. Hartogensis cited his experience in "consensus building" as one of his primary qualifications for the post. When asked by members of the Committee about his priorities if he were to be confirmed, Mr. Hartogensis stated that he would prioritize issues related to the multiemployer pension insurance program and cybersecurity. He also proposed increasing premiums and imposing premiums on plan participants as a potential solution to shore up PBGC's multiemployer insurance program.

It is expected that the Senate Finance Committee will approve Mr. Hartogensis' nomination when the Senate returns after the mid-term elections. The Senate Committee on Health, Education, Labor, and Pensions – which also has jurisdiction over PBGC – has not signaled that it will take official action on the nomination. Thus, the full Senate may take up the nomination later this year, though the timing is still uncertain.

Mr. Reeder has been PBGC Director since 2015 and has overseen significant developments at the agency, including changes to Early Warning Program enforcement, the development of a new missing participants program, and the implementation of the Multiemployer Pension Reform Act. It is expected that Mr. Reeder will continue to serve as Director until a new Director is confirmed. His term does not expire until 2020.

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For additional information or to discuss PBGC issues, please contact the authors or your Groom attorney.

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