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BENEFITS BRIEF

September 21, 2015 www.groom.com

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PBGC Issues Final "Reportable Event" Regulations

The Pension Benefit Guaranty Corporation ("PBGC") recently issued final regulations on reportable events under section 4043 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). 80 Fed. Reg. 54980 (Sept. 11, 2015). The new regulations significantly revise longstanding rules governing when administrators and sponsors of defined benefit pension plans need to report certain events to PBGC and signal a fundamental shift in PBGC's view of the types of events that merit the agency's attention. In particular, the final regulations focus on indicators of plan sponsors' financial health rather than merely the health of the pension plans. The new regulations apply to post-event reports for reportable events occurring on or after January 1, 2016, and to advance reports due on or after that date.

The final regulations provide, among other things,

- Safe harbor waivers from reporting based on the financial soundness of plan sponsors and plans,
- Small plan, foreign entity, and *de minimis* waivers for certain reportable events,
- A waiver of the reporting requirements for public companies for events that are already disclosed under SEC rules,
- Revised definitions under some reportable events, and
- Required electronic reporting.

The new regulations are complicated, and plan sponsors will want to ensure they have systems in place to track potential reportable events, and the information necessary to determine whether a waiver is available.

<u>Background</u> – ERISA section 4043 and the reportable event regulations (29 C.F.R. Part 4043) require plan administrators and sponsors of defined benefit pension plans to notify PBGC of certain events that may signal problems with a pension plan or contributing employer. 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. Failure to timely report may result in a penalty of up to $1,100 per day, although the PBGC generally reduces the penalty for most reportable events. ERISA § 4071; 29 C.F.R. § 4071.

PBGC uses the reporting of these events to determine whether the events present a risk to PBGC's pension insurance system, or to plan participants. In order to better target the plans and sponsors that pose these financial risks, PBGC updated the reportable events rules to focus more on the financial health of plan sponsors rather than merely the health of plans.

The new rules represent a significant and controversial change in focus for the agency. In fact, after the rules were first proposed in 2013, PBGC held a very rare public hearing to collect public comment.

Below, we summarize the key provisions included in the final regulations.

Reporting Waivers – The final regulations establish several waivers for reporting certain events. Many of the waivers in the final rules follow the 2013 proposed rules. *See* 78 Fed. Reg. 20039 (Apr. 3, 2013).

Low-Default-Risk Safe Harbor – The low-default-risk safe harbor waives the reporting requirement if the plan sponsor is considered to be "low default risk". A company is considered to have "low default risk" if both the plan sponsor **and** the highest level U.S. parent entity satisfy either (1) the first two, or (2) any four, of the following criteria during the "safe harbor period":

1. The probability that the company will default is not more than 4% over the next five years, or not more than 0.4% over the next year, based on widely available information on the company's credit quality.
2. The company's secured debt does not exceed 10 percent of its total asset value.
3. The company's ratio of retained-earnings-to-total-assets is 0.25 or more.
4. The company's ratio of total-debt-to-EBITDA is 3.0 or less.
5. The company has positive net income for the two most recent completed fiscal years.
6. The company has not experienced any default on certain loans in the last two years (regardless of whether it was required to be reported to the PBGC).
7. The sponsor has not experienced a missed contribution event in the past two years (unless PBGC reporting was waived).

The "safe harbor period" begins on the date on which (1) a public company files a Form 10-K with the SEC, (2) a non-public company closes the annual accounting period for financial statements purposes, or (3) a company that does not have annual financial statements files a federal income tax return or a Form 990 with the IRS. The safe harbor period ends 13 months later, or upon the next filing of the financial information, if earlier. Generally, the aforementioned financial information used to determine the start of the safe harbor period will be the same used to determine whether this safe harbor applies, i.e., public companies will use the SEC Form 10-K information, non-public companies will use the company's financial statements as of the closing of the last annual accounting period, and non-public companies that do not have annual financial statements will use the federal income tax return or Form 990 information. A company that has received a material, adverse view or qualification from an accountant, cannot qualify for the safe harbor.

Events Waived: The low-default-risk safe harbor applies for the following reportable events:

- Extraordinary Dividend or Stock Redemption
- Change in Contributing Sponsor or Controlled Group

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- Active Participant Reduction
- Transfer of Benefit Liabilities
- Distribution to Substantial Owner

Well-Funded Plan Safe Harbor – The final regulations also provide a safe harbor from reporting certain events when the pension plan is sufficiently funded. To qualify, a plan must have not been required to pay PBGC variable-rate premiums in the year preceding the event. (Generally, this means the plan was 100 percent funded on an ongoing basis, disregarding pension smoothing.)

Events Waived: The well-funded plan safe harbor applies for the following reportable events:

- Extraordinary Dividend or Stock Redemption
- Change in Contributing Sponsor or Controlled Group
- Active Participant Reduction
- Transfer of Benefit Liabilities
- Distribution to Substantial Owner

Public Company Waiver – The final rule waives reporting when any contributing sponsor of a plan is a public company that timely files a SEC Form 8-K disclosing the event, except where disclosure is under an 8-K relating primarily to results of operations or financial statements (SEC Form 8-K Item 2.02 and Item 9.01). A Form 8-K related to Item 2.02 or Item 9.01 may only contain passing references to the PBGC reportable event, with little information and may be filed long after the event may have occurred. For all other SEC Form 8-K filings, PBGC noted that the SEC filing was sufficient to notify the PBGC, so separate reporting to PBGC is waived.

Events Waived: The public company waiver applies for the following reportable events:

- Extraordinary Dividend or Stock Redemption
- Change in Contributing Sponsor or Controlled Group
- Active Participant Reduction
- Transfer of Benefit Liabilities
- Distribution to Substantial Owner

Small Plan Waiver – Under the final regulations, plans with 100 or fewer participants are not required to report certain events.

Events Waived: The small plan waiver applies to the following reportable events:

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- Extraordinary Dividend or Stock Redemption
- Change in Contributing Sponsor or Controlled Group
- Active Participant Reduction
- Transfer of Benefit Liabilities
- Failure to make a Required Contribution (but only for quarterly contributions)

Foreign Entity Waiver – When an entity involved with certain reportable events is a foreign entity and not the contributing sponsor of the plan, the final regulations waive the reporting requirement. For these purposes, a foreign entity generally is a controlled group member that:

(1) Is not organized under the laws of any state in the United States, and

(2) Either of the following:

(i) Is not required to file any United States federal income tax form,

(ii) Has no income reportable on any United States tax form other than passive income not over $1,000, or

(iii) Does not own substantial assets in the United States (disregarding stock of a controlled group member) and is not required to file any quarterly United States tax returns for employee withholding.

Events Waived: The foreign entity waiver applies for the following reportable events:

- Extraordinary Dividend or Stock Redemption
- Change in Contributing Sponsor or Controlled Group
- Insolvency
- Liquidation
- Loan Default

***De Minimis* Waiver** – Following the 2013 proposed rules, the final regulations also waive reporting for certain events if a transaction involves a *de minimis* percentage of the overall controlled group. *De minimis* transactions are those in which the person or persons that will cease to be members of the plan's controlled group represent a *de minimis* 10 percent segment of the plan's old controlled group for the most recent fiscal year(s) ending on or before the date the reportable event occurs. A *de minimis* 10 percent segment means, in

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connection with a plan's controlled group, one or more entities that in the aggregate meet all of the following for a fiscal year:

(1) Revenue not exceeding 10 percent of the controlled group's revenue;

(2) Annual operating income not exceeding the greater of:

(i) 10 percent of the controlled group's annual operating income or

(ii) $5 million; and

(3) Net tangible assets at the end of the fiscal year(s) not exceeding the greater of:

(i) 10 percent of the controlled group's net tangible assets at the end of the fiscal year(s); or

(ii) $5 million.

Events Waived: The *de minimis* waiver applies for the following reportable events:

- Extraordinary Dividend or Stock Redemption
- Change in Contributing Sponsor or Controlled Group
- Insolvency (if the entity is not the contributing sponsor)
- Liquidation (if the entity is not the contributing sponsor)
- Loan Default (if the entity is not the contributing sponsor)

Key Changes to Descriptions of Events that are Reportable – The final rules also change the definition of certain events that are to be reported to PBGC.

Active Participant Reduction – A reportable event occurs when the number of active participants is reduced below 80 percent of the number at the beginning of the year, or below 75 percent of the number at the beginning of the prior year, with several automatic extension provisions. The final rules provide a reporting extension to the due date for the sponsor's PBGC premiums (generally October 15th for calendar year plans), unless, during the plan year, the participant reduction occurred as a result of a single cause, such as a reorganization, natural disaster, mass layoff, or an early retirement program.

Controlled Group Changes – Under the final regulations, no reportable event occurs when one member of a controlled group merges into another. They also provide that whether an agreement to change a controlled group is legally binding—which triggers this reporting requirement—should be determined without regard to whether conditions in the agreement have been met or satisfied, similar to the "material definitive agreement" under Item 1.01 of the SEC Form 8-K.

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Loan Default – The loan default event has been updated. Prior to these new regulations, a reportable event occurred if a sponsor had a loan with $10 million or more outstanding, and it had a default or an event that accelerated the payments. The final rules now expand the definition to require reporting when there is an amendment or waiver of any loan agreement covenant for the purpose of avoiding a default.

Missed Contributions – The final regulations clarify that the reportable event for missed contributions applies not only to contributions required by statute, but also to contributions required as a condition of obtaining a funding waiver. The rules retain the current grace-period waiver for missed contributions that are made within 30 days. However, the current 10-day reporting deadline for missed contributions exceeding $1 million in the aggregate, required under section 303(k) of ERISA and section 430(k) of the Internal Revenue Code of 1986, as amended, ("Code") remains unchanged.

Inability to Pay Benefits When Due – Because many large plans are subject to liquidity shortfall rules under the Code and ERISA, there is no need to report when the plan is not able to pay benefits when due. The final regulations adopt the 2013 proposed rule, which clarified that the large plan waiver applies to plans that are have more than 100 participants (*i.e.*, plans that do not meet the "small plan" definition in section 303(g)(2) of ERISA and section 430(g)(2) of the Code).
In addition, the new regulations no longer require a plan to report the failure to pay benefits when due because the payee is missing. Previously, a reportable event occurred if a payee hadn't been found after two months. PBGC recognized that plans fiduciaries have a duty to locate these participants.

Distributions to Substantial Owners – In prior years, the regulations required reporting if a distribution to a substantial owner exceeded $10,000 a year, with some exceptions. The new regulations require reporting only if the distribution is greater than $10,000 and also exceeds one percent of plan assets for each of the two preceding plan years, or distributions to all substantial owners exceeds five percent of plan assets for each of the two preceding plan years. Regardless of the size of the distribution, a distribution to a substantial owner in the form of an annuity need only be reported once; there is no need to report ongoing annuity distributions.

Extraordinary Dividends – Following the 2013 proposed regulation, the final regulations provide that a reportable event occurs when a dividend or redemption exceeds 100 percent of net income for the prior fiscal year, simplifying the old rule that providing for one-year and four-year testing periods and disregarding distributions within a controlled group.

Transfer of Benefit Liabilities – The final rules clarify that the payment of a lump sum or the purchase of an irrevocable commitment to provide an annuity do not constitute transfers of benefit liabilities that need to be reported. The rules also describe that the advance reporting requirement for this event is only applicable for the transferor plan, not both the transferee and transferor plan.

Insolvency if in Bankruptcy – The final rules do not require the reporting for an insolvency if the plan sponsor commences, or has commenced against it, a case under the Bankruptcy Code. PBGC monitors bankruptcy filings on insolvency outside of the reportable event program.

Form 200 Simplification – Under the prior rules, if a sponsor missed a contribution (and the outstanding balance of missed contributions was in excess of $1 million) the sponsor needed to include several attachments to the Form 200, even if the missed contribution was made up in the interim. Under the new rules, any sponsor that makes up the missed contribution by the Form 200 deadline and has not missed any other required contribution within the previous 2 years does not need to submit any attachments otherwise required by the Form 200 instructions.

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