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PENSION & BENEFITS

REPORTER

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SPECIAL REPORT

PBGC Issues Guidance on Premium Changes

BY HAROLD J. ASHNER

The rules governing Pension Benefit Guaranty Corporation premiums have recently undergone significant changes, and more change is on the horizon. Flat-rate premiums shot up for the 2006 plan year and are now statutorily ordained to increase over time. An ongoing employer whose plan terminates in a distress or involuntary termination on or after Jan. 1, 2006, may have to grapple with a new and hefty ''termination premium.'' As for the variable-rate premium (''VRP''), some of the rules are changing for the 2007 plan year, with a complete overhaul slated to go into effect starting with the 2008 plan year. And for those who overpay their premiums, relief in the form of interest payments by PBGC may be on its way through an expected PBGC rulemaking action.

PBGC recently issued guidance on several of these premium changes in the form of a technical update and a proposed rule:

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■ *Technical update.* On Feb. 13, 2007, PBGC issued Technical Update 07-1 (''Effect of Treasury Mortality Tables on PBGC Requirements'') to provide guidance on how the Department of the Treasury's recent issuance of new mortality tables for determining current liability affects not only VRP determinations for the 2007 plan year, but also those PBGC reporting requirements that are tied to the 2007 VRP.[1]

■ *Proposed rule.* On Feb. 20, 2007, PBGC published a proposed rule that provides guidance (albeit only in proposed form) on the flat-rate premium increase that went into effect starting with the 2006 plan year, the new termination premium that went into effect for certain distress and involuntary terminations in or after 2006, and a new cap on the VRP for small employers that is going into effect starting with the 2007 plan year.[2]

A final version of this proposed rule is of course still to come, as is PBGC guidance on other premium changes:

■ *2008 VRP changes.* PBGC's semiannual regulatory agenda[3] projects the publication of a proposed rule in May 2007 that will address changes to the VRP rules made by the Pension Protection Act of 2006 (''PPA''). These changes, which generally go into effect starting

[1] Technical Update 07-1, which was issued (as noted) on Feb. 13, 2007, and revised on Feb. 15, 2007, is available at http://pbgc.gov/practitioners/law-regulations-informal-guidance/content/tu15995.html.

[2] The proposed rule, published at 72 Fed. Reg. 7755, is available at http://www.pbgc.gov/docs/E7-2812.pdf.

[3] *See* 71 Fed. Reg. 74074, 74076 (Dec. 11, 2006), available at http://www.pbgc.gov/docs/ua061039.pdf.

with the 2008 plan year, include the elimination of the full-funding limit exemption and the coordination of the rules for calculating "unfunded vested benefits" ("UVBs") with the new PPA funding rules that also generally go into effect starting with the 2008 plan year.

■ *Interest on premium overpayments*. Although not yet on PBGC's regulatory agenda, PBGC is expected to issue regulations addressing its newly-granted PPA authority to pay interest on premium overpayments.[4]

The focus of this article is on the recently-issued PBGC guidance on the effect of the new Treasury mortality tables; on the flat-rate premium increase; on the new termination premium; and on the new small-employer cap on the VRP.

I. Effect of Treasury Mortality Tables

On Feb. 2, 2007, the Department of the Treasury, Internal Revenue Service, published a final rule requiring the use of new mortality tables for determining current liability for plan years beginning on or after Jan. 1, 2007.[5] Under the ERISA rules governing the calculation of UVBs for purposes of the VRP,[6] as interpreted by PBGC, these new current liability mortality tables trigger several changes in the UVB calculation for purposes of determining the 2007 plan year VRP and determining the applicability of various PBGC reporting requirements that are tied to the 2007 plan year VRP.

A. PBGC Premium Calculations

As a result of the applicability of the new current liability mortality tables to the 2007 plan year, there are two changes that will apply to all plans when calculating UVBs for purposes of the 2007 VRP, *i.e.*, the VRP required to be paid *in* the 2007 plan year (by Oct. 15, 2007, for calendar-year plans):

■ *Higher interest rate*. The Required Interest Rate used to value vested benefits for purposes of calculating UVBs increases from 85 percent to 100 percent of the annual rate of interest determined by the Secretary of the Treasury on amounts invested conservatively in long-term investment-grade corporate bonds (the "Composite Corporate Bond Rate"). The use of a higher valuation rate (*e.g.*, 5.75 percent instead of 4.89 percent for calendar-year plans) of course serves to reduce UVBs and the resulting VRP payment (assuming that there would otherwise be a VRP payment).

■ *Use of FMV of assets*. Fair market value of assets, rather than their actuarial value, is used to calculate UVBs, regardless of whether the "general rule" or the "alternative calculation method" (the "ACM") is used to make the calculation. For many plans—primarily those with recent favorable investment experience for which the actuarial value of assets is based on a smoothing technique—the use of fair market value of assets will result in a further reduction of UVBs and the resulting VRP payment (again, assuming that there would otherwise be a VRP payment).

Use of the new current liability mortality tables themselves (which assume longer life spans for most populations) in calculating UVBs would in many cases serve to *increase* UVBs and the resulting VRP payments, thus at least partially offsetting the decreases resulting (for all plans) from the use of a higher interest rate and (for many plans) from the use of fair market value of assets. However, the vast majority of plans will *not* have to reflect the new current liability mortality tables when calculating UVBs for purposes of the 2007 VRP. This is because the "premium snapshot date" used to calculate UVBs for purposes of the 2007 VRP is generally the last day of the *2006* plan year,[7] and the mortality assumptions to be used are those for the plan year that includes the premium snapshot date,[8] *i.e.*, the 2006 plan year (when the old mortality assumptions were still in effect). However, there are some relatively limited circumstances in which a plan *will* have to reflect the new current liability mortality tables in its UVB calculations for purposes of the 2007 VRP:

■ *"Merger/spinoff rule" plans*. The premium snapshot date for a plan that is subject, for the 2007 plan year, to the special rule[9] that shifts the premium snapshot date from the last day of the preceding plan year to the first day of the current plan year—the transferor plan in a non-de minimis spinoff, and the transferee plan in a non-de minimis merger, that takes effect at the beginning of the current plan year—will be the first day of the 2007 plan year, and such a plan would therefore have to reflect the new current liability mortality tables for 2007 premiums *if* it uses the "general rule" to calculate UVBs. If the plan instead uses the ACM, it would determine its *2007* UVBs using specified regulatory formulas that adjust vested benefit amounts that were required to be reported, as of the first day of the *2006* plan year, on the plan's *2006* Form 5500, Schedule B, and thus would base UVBs on old (2006) mortality. Although large plans, *i.e.*, those with 500 or more participants for the 2007 plan year, must make adjustments to the Schedule B entries under the ACM to reflect any "significant events" since the date as of which those entries were determined, there is informal guidance from PBGC staff providing that a change to new current liability mortality tables is not such a "significant event."[10]

■ *New and newly covered plans*. The premium snapshot date for a "new plan" or a "newly-covered plan" for the 2007 plan year necessarily falls in the 2007 plan year (generally the first day of the 2007 plan year),[11] and such a plan would therefore have to reflect the new current liability mortality tables for 2007 premiums *if* it

[4] In a Sept. 19, 2006, interview, PBGC's Interim Director, Vincent K. Snowbarger, told BNA that PBGC would be issuing regulations in this area and noted the possibility that the regulations could provide for retroactive interest. See "PBGC's Priorities Include Missing Participants and Interest on Overpayment of Premiums," (No. 182, BNA *Pension & Benefits Daily*, Sept. 21, 2006). (Under PPA Section 406, PBGC is authorized to pay, "subject to regulations prescribed by [PBGC]," interest on premium overpayments for periods beginning not earlier than PPA's Aug. 17, 2006, enactment date.)

[5] 72 Fed. Reg. 4955. For most single-employer plans, these new mortality tables will be used only for the 2007 plan year because the complete overhaul of the funding rules under PPA that will go into effect starting with the 2008 plan year eliminates the need to calculate current liability. However, these new mortality tables will be used for post-2007 plan years for those plans that are subject to later effective dates (pursuant to PPA Sections 104, 105, or 106) for the PPA funding overhaul.

[6] ERISA Section 4006(a)(3)(E)(iii).

[7] *See* 29 CFR § 4006.4(a).

[8] *See* 2007 Premium Payment Package at pp. 1 and 32.

[9] 29 CFR § 4006.5(e).

[10] *See* Q&A 4 of the 2000 Enrolled Actuaries Meeting Blue Book, available at http://www.pbgc.gov/docs/2000bluebook.pdf.

[11] *See* 29 CFR § 4006.5(d).

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uses the "general rule" to calculate UVBs. (A newly-covered plan for the 2007 plan year that was required to file a Form 5500, Schedule B, for the 2006 plan year may, according to informal guidance from PBGC staff, use the ACM to calculate 2007 UVBs[12] and thus may not need to reflect the new current liability mortality tables.)

■ *Plans with short plan years.* Where a plan undergoes a change in plan year, it may have two "2007" plan years, *i.e.*, two plan years that begin in 2007. Because the premium snapshot date for the second 2007 plan year will necessarily fall in a 2007 plan year (generally the last day of the first 2007 plan year), such a plan would have to reflect the new current liability mortality tables for 2007 premiums.

Notwithstanding these relatively limited exceptions, the bottom line is that most plans for which a VRP would otherwise have been payable for the 2007 plan year will see that VRP decrease, in some cases by quite a bit, as a result of the UVB calculation changes triggered by issuance of the new current liability mortality tables.

B. PBGC Reporting Requirements

The changes to UVB calculations for 2007 VRP purposes track through to three categories of PBGC reporting requirements, each of which is tied to those UVB calculations: annual employer reporting under ERISA Section 4010, post-event reporting under ERISA Section 4043(a), and advance reporting under ERISA Section 4043(b). In Technical Update 07-1, PBGC explained how these three reporting requirements are affected by the changes to the 2007 UVB calculations.

1. Annual Employer Reports (ERISA Section 4010).

Certain controlled groups are required to file annual actuarial and financial information reports with PBGC under ERISA Section 4010. The primary reporting trigger is where the aggregate UVBs in plans maintained by the controlled group (disregarding plans with no UVBs), as determined for VRP purposes under ERISA Section 4006(a)(3)(E)(iii), exceed $50 million (the "$50 Million 4010 Gateway Test").[13] (Technical Update 07-1 does not address the changes that PPA Section 505 makes to the rules for determining whether reporting is required under ERISA Section 4010 "with respect to years beginning after 2007.") For this purpose, UVBs are calculated for each plan as of the "$50 Million 4010 Gateway Testing Date," *i.e.*, the last day of the plan year that ends within the "Information Year" (generally the employer's fiscal year, which in most cases is the calendar year). For example, in the typical situation where the controlled-group-wide fiscal year, as well as the plan year of each plan maintained by the controlled group, is the calendar year, the determination of whether an ERISA Section 4010 report is required for the 2006 Information Year (*i.e.*, the report that would be due April 16, 2007) is based on each plan's UVBs as of Dec. 31, 2006.

It is helpful to keep in mind that the $50 Million 4010 Gateway Testing Date generally serves as the premium snapshot date for the plan year that begins the next day, *e.g.*, the Dec. 31, 2006, $50 Million 4010 Gateway Testing Date is generally the premium snapshot date for the 2007 calendar plan year. For this reason, PBGC interprets its regulations as requiring the UVB determination for ERISA Section 4010 purposes to track the UVB determination for VRP purposes for the plan year that *begins* the day *after* the $50 Million 4010 Gateway Testing Date (*e.g.*, the *2007* plan year where the $50 Million Gateway Testing Date is Dec. 31, 2006), rather than for the plan year that *ends on* the $50 Million 4010 Gateway Testing Date (*e.g.*, the *2006* plan year where the $50 Million Gateway Testing Date is Dec. 31, 2006).[14] Thus, in an all-calendar-year situation, the UVB determination for the 2006 Information Year for ERISA Section 4010 purposes, which is made as of Dec. 31, *2006*, will track the UVB determination for VRP purposes for the *2007* plan year rather than for the *2006* plan year.

Technical Update 07-1 provides that, as a result of the new current liability mortality tables, for $50 Million 4010 Gateway Testing Dates on or after Dec. 31, 2006, and on or before Dec. 30, 2007—*i.e.*, those for which the UVB determination for ERISA Section 4010 purposes would track the UVB determination for VRP purposes for the *2007* plan year—UVBs are determined using 100 percent of the Composite Corporate Bond Rate and the fair market value of plan assets. The new current liability mortality tables would be used only in limited circumstances (see the discussion above under "PBGC Premium Calculations"). They *would* have to be used where a short plan year that *ends* on the $50 Million 4010 Gateway Testing Date *begins* in 2007; however, their use would not be required based on the shifting of the premium snapshot date from the last day of the 2006 plan year to the first day of the 2007 plan in certain circumstances—as could happen in the premium context discussed above and the reportable events context discussed below—because the PBGC's ERISA Section 4010 regulations nowhere provide for such a shifting of the $50 Million 4010 Gateway Testing Date.)

For the reasons discussed above under "PBGC Premium Calculations," at least some controlled groups that would otherwise have been required to file an ERISA Section 4010 report for the 2007 Information Year based on the $50 Million 4010 Gateway Test may not have to report as a result of the UVB calculation changes triggered by issuance of the new current liability mortality tables.

2. Post-Event Reporting (ERISA Section 4043(a)).

Under PBGC's reportable events rules governing post-event reporting, the plan administrator and contributing sponsor of a plan for which a reportable event (*e.g.*, bankruptcy, active participant reduction, change in contributing sponsor or controlled group) has occurred is required to notify PBGC of the reportable event within 30 days after they know or have reason to know of the occurrence of the event, unless a waiver or extension applies.[15] Technical Update 07-1 addresses the effect of the new current liability mortality tables on these waivers and extensions in general, and also addresses their effect in particular on the regulatory waiver (and the related extension) for a plan that would have "no UVBs" if UVBs were determined based on a

[12] *See* Q&A 1 of the 2003 Enrolled Actuaries Meeting Blue Book, available at http://www.pbgc.gov/docs/2003bluebook.pdf.
[13] ERISA Section 4010(b)(1); 29 CFR § 4010.4(a)(1), (b).
[14] *See* footnote 5 of Technical Update 07-1.
[15] ERISA Section 4043(a), (c); 29 CFR § 4043.20.

set of optional assumptions and methods prescribed for purposes of the $50 Million 4010 Gateway Test under ERISA Section 4010 (the ''4010 Optional Assumptions''), and on a waiver that is contained not in the reportable events regulation, but rather in Technical Update 97-6 (relating to reporting of missed quarterly contributions).

Waivers and Extensions—In General. The VRP-based waivers in PBGC's reportable events regulation are based on the plan's VRP status (in some cases with modifications) as of the ''testing date''—which is defined to match in all cases the premium snapshot date[16]—for the ''event year,'' *i.e.*, the plan year in which the reportable event occurs. In contrast, the VRP-based *extensions* are tied to the testing date for the plan year *preceding* the event year. In Technical Update 07-1, PBGC provided that, for purposes of determining whether a waiver (other than a ''no UVBs'' waiver or a waiver pursuant to Technical Update 97-6) applies to a reportable event that occurs in a plan year (*i.e.*, the ''event year) beginning in 2007, UVBs are determined using 100 percent of the Composite Corporate Bond Rate and the fair market value of plan assets. Similarly, to determine whether a reporting *extension* (other than a ''no UVBs'' extension) applies, UVBs are determined using 100 percent of the Composite Corporate Bond Rate and the fair market value of plan assets if the plan year *preceding* the event year begins in 2007 (*e.g.*, where the event year begins in 2008). In both cases, the new current liability mortality tables would be used only in limited circumstances (see the discussion above under ''PBGC Premium Calculations'').

'No UVB' Waiver/Extension. For several of the reportable events in PBGC's regulation,[17] a waiver or extension applies if, as of the testing date for the event year (in the case of a waiver) or for the plan year preceding the event year (in the case of an extension), the plan would have no UVB's if UVBs were determined in accordance with the 4010 Optional Assumptions.[18]Although PBGC removed the 4010 Optional Assumptions from its ERISA Section 4010 regulations,[19] it has allowed their continued use to qualify for this ''no UVBs'' waiver and extension under the reportable events regulation.[20] In Technical Update 07-1, however, PBGC noted that the 4010 Optional Assumptions applied, by their own terms under PBGC's ERISA Section 4010 regulations, only ''prior to the first information year in which the [new current liability mortality tables] apply to all the plans maintained by a controlled group.'' PBGC then explained how the issuance of the new current liability mortality tables affects the availability of the ''no UVB'' waiver and extension.

[16] *See* 29 CFR § 4043.2.

[17] 29 CFR §§ 4041.23 (active participant reduction), .27 (distribution to substantial owner), .29 (change in contributing sponsor or controlled group), .30 liquidation), .31 (extraordinary dividend or stock redemption), and .34 (loan default).

[18] 29 CFR § 4010.4(b)(2) (2004).

[19] PBGC's repeal of the 4010 Optional Assumptions for purposes of ERISA Section 4010 reports was effective for Information Years ending after Dec. 30, 2005. *See* 70 Fed. Reg. 11540, 11544 (March 9, 2005).

[20] For details, *see* Q&A 15 of the 2006 Enrolled Actuaries Meeting Blue Book, available at http://www.pbgc.gov/docs/2006bluebook.pdf.

■ *Waiver*. If the event year ends in an Information Year (as determined under PBGC's ERISA Section 4010 regulations) for which the new current liability mortality tables apply to all of the plans in the controlled group (*i.e.*, each of their plan years that *ends* in that Information Year *begins* in 2007 or later, as would be the case where the event year, the Information Year, and all plan years are the 2007 calendar year), the ''no UVBs'' waiver is no longer available.

■ *Extension*. The ''no UVBs'' extension, which is tied to the plan's VRP status (with some modifications) for the plan year *preceding* the event year, is no longer available if that *preceding* plan year ends in an Information Year for which the new current liability mortality tables apply to all of the plans in the controlled group (as would be the case, assuming again everything to be on a full calendar-year basis, where the event occurs in 2008).

Where the ''no UVBs'' waiver or extension *does* apply—*e.g.*, because one of the plans maintained by the controlled group has a *2006* plan year that ends in the same Information Year in which the event year (in the case of a waiver) or the preceding plan year (in the case of an extension) ends—the 4010 Optional Assumptions themselves require specified interest and mortality assumptions and the use of fair market value of assets; thus, the changes to the UVB calculation for VRP purposes that result from the issuance of the new current liability mortality tables would not track through to the ''no UVBs'' waiver calculation for reportable events purposes.

Technical Update 97-6 Waiver. In Technical Update 97-6, PBGC waived post-event reporting for certain small employers that fail to make quarterly contributions.[21] An employer with 100 or fewer participants in its defined benefit plans (determined on an aggregated controlled group basis) on each day of the plan year preceding the plan year for which the quarterly contribution was owed qualifies for this waiver. If this participant count exceeds 100 but not 500, the employer qualifies for this waiver only if a Participant Notice for the plan under ERISA Section 4011 was not required for the plan year for which the quarterly contribution is owed *or* was not required for the prior plan year. Although PPA repealed the ERISA Section 4011 Participant Notice requirement for plan years beginning after 2006, PBGC stated in Technical Update 06-4 that it would apply the Participant Notice element of Technical Update 97-6, with respect to missed quarterly contributions for a 2007 plan year, as if the Participant Notice requirement had not been repealed for that 2007 plan year. In determining whether a Participant Notice would thus be required (for purposes of Technical Update 97-6) for such a 2007 plan year, except where the plan meets a funding-related test tied to the deficit reduction contribution rules, it is necessary to determine whether a VRP is payable for the plan for that 2007 plan year. In Technical Update 07-1, PBGC explained that such a VRP determination for a 2007 plan year would be based on 100 percent of the Composite Corporate Bond Rate and the fair market value of plan assets. The new current liability mortality tables would be used only in limited cir-

[21] Technical Update 97-6 is available at http://www.pbgc.gov/practitioners/law-regulations-informal-guidance/content/tu12800.html.

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cumstances (see the discussion above under "PBGC Premium Calculations").

For the reasons discussed above under "PBGC Premium Calculations," at least some reportable events for which a VRP-based reporting waiver or extension would not otherwise have applied may qualify for the waiver or extension as a result of the UVB calculation changes triggered by issuance of the new current liability mortality tables.

3. Advance Reporting (ERISA Section 4043(b))

Under PBGC's reportable events rules governing advance reporting, in the case of certain non-public companies, the contributing sponsor of a plan for which any of a limited number of reportable events is going to occur is required to give PBGC notice at least 30 days before the event's effective date.[22] Generally, advance reporting is required if, in the aggregate (disregarding plans with no UVBs), the plans maintained by the controlled group have vested benefits amounts that exceed plan asset values by more than $50 million *and* a funded vested benefits percentage below 90 percent.[23] Vested benefits amounts and the funded vested benefits percentage (presumably as well as whether a plan has no UVBs and therefore is to be excluded from the advance reporting gateway test) are determined based on the plan's VRP status (in some cases with modifications) as of the "testing date"—which is defined to match in all cases the premium snapshot date—for the plan year that includes the effective date of the reportable event.[24]

In Technical Update 07-1, PBGC provided that, for a reportable event with an effective date in a plan year beginning in 2007, 100 percent of the Composite Corporate Bond Rate and the fair market value of assets are used to determine whether advance reporting is required. (The new current liability mortality tables would be used only in limited circumstances (see the discussion above under "PBGC Premium Calculations").) It is worth noting that, where there are plans with different plan year cycles, it is possible that some, but not all, of the plans maintained by a controlled group will be subject to the UVB calculation changes resulting from the issuance of new current liability mortality tables. This is because, *for each plan*, the plan year whose "testing date" is used in determining whether advance reporting is required is the plan year that includes the effective date of the reportable event,[25] and thus both post-2006 and pre-2007 plan years may need to be taken into account for a particular reportable event (*e.g.*, where the reportable event becomes effective on April 1, 2007, during the *2007* plan year of a calendar-year plan and the *2006* plan year of a plan maintained on a July 1 plan year cycle).

For the reasons discussed above under "PBGC Premium Calculations," at least some reportable events for which advance reporting would otherwise have been required may fall outside the advance reporting requirement as a result of the UVB calculation changes triggered by issuance of the new current liability mortality tables.

[22] *See* ERISA Section 4043(b)(3); 29 CFR § 4043.61(a).
[23] *See* ERISA Section 4043(b)(1); 29 CFR § 4043.61(b)(2), (c).
[24] *See* 29 CFR § 4043.2, .61(c)(3).
[25] *See* 29 CFR § 4043.61(c)(3).

II. Flat-Rate Increase

The Deficit Reduction Act of 2005 ("DRA 2005"), which was signed by the President on Feb. 8, 2006, called for an immediate increase in PBGC's per-participant flat-rate premium. The increase was significant, jumping from $19 to $30 for single-employer plans and from $2.60 to $8 for multiemployer plans, effective for plan years beginning on or after Jan. 1, 2006. For plan years beginning on or after Jan. 1, 2007, these rates are automatically adjusted each year to track increases in the national average wage index currently used for Social Security indexing. The adjustment is based on the ratio of the index for the calendar year two years in the past (*e.g.*, the index for the *2005* calendar year in the case of the 2007 plan year) to that index for the 2004 calendar year, with the resulting rate to be rounded to the nearest multiple of $1. The statute precludes any year-to-year decreases by requiring the rate for any post-2006 plan year to be at least what it was for the immediately preceding plan year. For the 2007 plan year, the single-employer flat-rate premium increased from $30 to $31 (rounded down from $31.10), and the multiemployer flat-rate premium remained at $8 (rounded down from $8.29).[26]

PBGC's proposed rule in most respects simply incorporates the statutory language into its premium regulations. However, the preamble to the proposed rule notes three minor (and entirely noncontroversial) clarifications:

- *Applicability of single-employer increase.* After noting that the revised statutory language, read literally, "makes it appear that the $30 single-employer flat-rate premium applies to plan years beginning after 1990," the preamble stated that, in light of the DRA 2005 language (which was not codified) making clear that the increase applies only to post-2005 plan years, "PBGC considers single-employer flat premium rates for plan years beginning before 2006 to be unaffected by DRA 2005."[27]

- *Continued use of snapshot date for multiemployer premiums.* The preamble notes that the statutory language addressing the per-participant flat-rate premium for multiemployer plans applies the rate to "each individual who is a participant in such plan *during* the applicable plan year" (emphasis supplied). Analogizing to PBGC's interpretation of nearly identical (and long-standing) language relating to the single-employer flat-rate premium, the preamble stated that "PBGC interprets this to mean that the participant count is to be taken as of the premium snapshot date described in the premium rates regulation and PBGC's premium instructions (generally the last day of the plan year preceding the premium payment year)."[28]

- *Use of standard rounding convention.* The DRA 2005 rules require PBGC to round each plan year's premium rates to the nearest whole dollar. The preamble notes that "PBGC interprets this to mean that if the adjustment formula would produce an unrounded premium rate of some number of dollars plus 50 cents, the premium rate will be rounded up."[29]

[26] 71 Fed. Reg. 69602 (Dec. 1, 2006).
[27] 72 Fed. Reg. at 7755.
[28] *Id.*
[29] *Id.* at 7756.

III. New 'Termination Premium'

Of particular significance to financially troubled sponsors, DRA 2005 adds a new flat-rate termination premium for an employer who terminates a plan in a distress or involuntary termination and continues in business.[30] This new termination premium, or ''exit fee'' as some call it, is a hefty one: not $30 per participant, but $1,250 per participant, per year, for three years.[31] Consider by way of example a plan with 4,000 participants: the termination premium over the three-year period comes to $15 million.

Under the DRA 2005 rules, as further amended by PPA:

■ *Timing of covered plan terminations.* The termination premium generally applies only to certain ''plans terminated after Dec. 31, 2005.'' (DRA 2005 had provided that the termination premium would not apply with respect to any plan terminated after Dec. 31, 2010, but PPA Section 401(b)(1) repealed this sunset provision.)

■ *Types of covered plan terminations.* The termination premium applies where the termination is ''under'' any of certain specified distress tests (*i.e.*, the ''reorganization'' test,[32] the ''inability to continue in business'' test,[33] or the ''unreasonably burdensome pension costs'' test,[34] but *not* the ''liquidation'' test[35]) or ERISA Section 4042 (providing for involuntary terminations). It does *not* apply to standard terminations.

■ *Persons responsible for paying termination premium.* The ''designated payor'' is the ''person who is the contributing sponsor as of immediately before the termination date.'' (Pre-existing language in ERISA Section 4007(e)(2) providing that each member of the contributing sponsor's controlled group is jointly and severally liable for premiums was not changed by DRA 2005 or PPA.)

■ *Participant count.* The termination premium is to be calculated based on the number of ''participants in the plan immediately before the termination date.''

■ *Due dates in general.* The termination premium is due within 30 days after the beginning of each of three ''applicable 12-month periods,'' with the first such period generally starting with ''the first month following the month in which the termination date occurs.'' (The second and third ''applicable 12-month periods'' are simply those that follow the first such period.)

■ *Due date deferrals for reorganizations.* The start of the first period is deferred (resulting in later due dates), in the case of certain distress or involuntary terminations that occur during reorganization proceedings, until ''the first month following the month which includes the earliest date as of which each such person is discharged or dismissed in the [reorganization] case.''

PBGC's proposed rule addressed several interpretive issues relating to the new termination premium.

A. Timing of Covered Plan Terminations

PBGC interpreted the language applying the new termination premium to certain plans that are ''terminated'' after Dec. 31, 2005, to refer to the plan's termination date under ERISA Section 4048.[36] Under this interpretation, employers whose plans terminate with pre-2006 termination dates that are not established until after 2005 are not subject to the new termination premium.

B. Types of Covered Plan Terminations

PBGC noted that the statutory provisions applying the termination premium to distress terminations ''under'' certain of the distress tests (but not including the liquidation test) do not make clear ''whether the termination premium is to apply to terminations where one or more contributing sponsors and/or controlled group members meet the [liquidation test], but others meet [the reorganization test, the inability to continue in business test, or the unreasonably burdensome pension costs test].'' After noting that all contributing sponsors and their controlled group members are liable for plan underfunding when their plan terminates and for the termination premium itself, and must each satisfy one or another of the distress tests for a distress termination to take place, PBGC concluded that ''the fact that one entity among several is liquidating should not shield the others from liability.'' The preamble stated that PBGC interprets the statutory language ''as applying the termination premium in any distress termination where at least one contributing sponsor or controlled group member meets [the reorganization test, the inability to continue in business test, or the unreasonably burdensome pension costs test], *i.e.*, is not liquidating.''[37]

C. Persons Responsible for Paying Termination Premium

The statutory language makes clear that the designated payor is the person who is the contributing sponsor of the plan immediately before the termination date. In its proposed rule, in addition to tying this determination to the day before the termination date, PBGC also tied the determination of which persons are in the contributing sponsor's controlled group, and thus are jointly and severally liable for the termination premium, to the day before the termination date.[38]

Under the proposed rule, *each* contributing sponsor and *each* controlled group member (determined as of the day before the termination date) is responsible for

[30] There is an exception under which the termination premium does not apply to a plan terminated during bankruptcy reorganization proceedings pursuant to a bankruptcy filing before Oct. 18, 2005. *See* DRA 2005 Section 8101(d)(2)(B). However, pursuant to PPA Section 402(g)(2)(B)(ii), this exception does not apply to an ''eligible plan''' under PPA Section 402(c)(1) (generally a plan of a commercial passenger airline or airline catering service) while a funding election under PPA Section 402(a)(1) is in effect for the plan.

[31] The termination premium rate doubles to $2,500 where a commercial passenger airline or airline catering service elects funding relief for a frozen plan under PPA Section 402(a)(1), if the plan terminates during the first five years of the funding relief period, unless the Secretary of Labor determines that the termination resulted from extraordinary circumstances such as a terrorist attack or similar event. This increased termination premium applies notwithstanding that a plan is terminated during bankruptcy reorganization proceedings pursuant to a bankruptcy filing before Oct. 18, 2005. *See* PPA Section 402(g)(2)(B).

[32] ERISA Section 4041(c)(2)(B)(ii); 29 CFR § 4041.41(c)(2).

[33] ERISA Section 4041(c)(2)(B)(iii)(I); 29 CFR § 4041.41(c)(3).

[34] ERISA Section 4041(c)(2)(B)(iii)(II); 29 CFR § 4041.41(c)(4).

[35] ERISA Section 4041(c)(2)(B)(i); 29 CFR § 4041.41(c)(1).

[36] 72 Fed. Reg. at 7756-57.

[37] *Id.* at 7757.

[38] *Id.*

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filing the required termination premium information and for making the required payment, although any one of them may act on behalf of all. PBGC explained that this provision serves to ''ensure[ ] that, so long as there is at least one person still in existence that is liable for the termination premium, there will be at least one identifiable entity with responsibility to file.'' Although ''only a single filing of the premium and required premium information is required,'' if such a filing ''is not timely made, PBGC could seek enforcement against any or all contributing sponsors and controlled group members.''[39] The proposed rule also places recordkeeping responsibilities with respect to the new termination premium on *each* contributing sponsor and *each* controlled group member.[40]

D. Due Dates

After noting by way of analogy its interpretation relating to covered plan terminations where one or more contributing sponsors and/or controlled group members meet the liquidation test, but one or more meet the reorganization test, the inability to continue in business test, or the unreasonably burdensome pension costs test, PBGC ''conclude[d] that the bankruptcy reorganization deferral provision in new section 4006(a)(7)(B) of ERISA is meant to apply to a distress termination only when at least one contributing sponsor or controlled group member satisfies the bankruptcy reorganization test in section 4041(c)(2)(B)(ii).'' The preamble went on to explain how these rules work where there are multiple entities involved in bankruptcy reorganization proceedings:

> [W]here the special bankruptcy rule for due dates applies, it is necessary to identify every contributing sponsor and controlled group member that was involved in bankruptcy reorganization proceedings on the termination date and determine the date when each one left bankruptcy—through dismissal of or discharge from the proceeding—or ceased to exist. (If an entity ceases to exist, its failure to emerge from bankruptcy should not postpone the termination premium due date.) Under new section 4006(a)(7)(C)(ii), the first applicable 12-month period for the termination will then begin with the calendar month that next begins following the last such date.[41]

The preamble also addressed how the termination premium due date rules would work in the context of termination dates that are retroactively established.[42] Noting that in such circumstances termination premium payments ''could be overdue before it was determined they were owed,'' the preamble stated that, ''PBGC considers it appropriate to provide that where the termination date is set retroactively, the first applicable 12-month period does not begin immediately after the month in which the termination date falls, but rather begins immediately after the month in which the termination date is established.'' (The preamble noted that this could result in a further extension where the special bankruptcy rule for due dates applies.)

E. Late Payment Penalties

Under PBGC's existing payment of premiums regulation, a late payment penalty is automatically assessed for late payment of premiums, subject to waiver in certain prescribed circumstances (including where there is a showing of reasonable cause for the late payment). The penalty rate is set at 1 percent per month or 5 percent per month depending on the timing of the payment in relation to PBGC's issuance of any notice that there is or may be a premium delinquency, subject to the statutory limit of 100 percent of the unpaid premium.[43] In the proposed rule implementing the new termination premium, PBGC opted *not* to apply this same penalty approach, but rather chose an approach that allows for considerably more PBGC discretion:

> Section 4007.13(c) provides for a discretionary ''facts-and-circumstances'' penalty for failure to pay the termination premium timely, instead of the automatic 1 percent or 5 percent penalty that applies to late payment of flat- and variable-rate premiums under § 4007.8(a). PBGC wants to preserve flexibility in penalizing failures to pay the new premium in full and on time while it gains experience with the new premium. The penalty is limited to 100 percent of the amount of termination premium not timely filed.[44]

This flexibility would allow PBGC *not* to assess *any* penalty for late payment, regardless of whether a penalty waiver would otherwise be appropriate. On the other hand, there is no specific limit to the amount PBGC could assess, even where a premium is paid just a few days late, other than the statutory limit of 100 percent of the unpaid premium amount. Hopefully and presumably, PBGC will act reasonably in exercising this discretion.

F. Issues Not Addressed

The proposed rule, perhaps understandably, does not address a number of issues that may affect whether the new termination premium will end up being as significant an issue as the sheer numbers suggest. First, it is not clear that the termination premium will hold up in court. In at least one case, a challenge has been mounted on the basis that the termination premium is, in effect, a pre-petition general unsecured claim that has been discharged in bankruptcy.[45] Second, it is possible that the threat of a termination premium will result in more Chapter 11 debtors undergoing an asset sale followed by liquidation because of the difficulty that the termination premium will present when trying to develop a feasible plan of reorganization. Third, it is not clear to what extent PBGC will be willing to reach a settlement of the termination premium liability in much the same way it settles its claims for employer liability, unpaid contributions, and premiums, both in and out of bankruptcy. To get answers to these questions, we will have to await developments in the courts, actions by Chapter 11 debtors, and actions by PBGC.

IV. Small Employer VRP Cap

PPA Section 405 creates a cap on the VRP for plans maintained by small employers, effective starting with the 2007 plan year. This provision will help many plans for which the VRP, which is calculated as a percentage of underfunding for *vested* benefits, has been excessive in relation to underfunding for *guaranteed* benefits. In

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[39] *Id.* at 7759.
[40] *Id.* at 7761 (proposed § 4007.10(a)(3)(ii)).
[41] *Id.* at 7758.
[42] *Id.*
[43] *See* 29 CFR § 4007.8.
[44] 72 Fed. Reg. at 7759.
[45] *Oneida Ltd. v. PBGC*, Adversary Proceeding in Case No. 06-10489 (Bankr. S.D.NY)

the pre-PPA environment, it was common for there to be a significant gap between vested and guaranteed benefits for small plans in which one or more substantial owners participate, given the special limitations on the guarantee for substantial owners. Although PPA Section 407 improves the guarantee for substantial owners, particularly those who are not majority owners, there will likely continue to be significant gaps between vested and guaranteed benefits for many small plans.

To qualify for the cap, there must be no more than 25 employees in the entire controlled group as of the first day of the premium payment year, and the cap for each participant is $5 times the number of participants. Unfortunately, this PPA provision has led to quite a bit of confusion.

■ *Covered plans.* Part of the confusion is because one counts *employees* to determine eligibility for the cap, but then counts *participants* to compute the cap. So a plan with 10 participants *does not* qualify if there are 50 employees in the controlled group, and a plan with 50 participants, including many retirees and terminated vested participants, *does* qualify if there are only 10 employees in the controlled group.

■ *Computation of cap.* Another area of confusion relates to the cap itself; for a plan with 20 participants, some practitioners seem to think that the cap for the plan is 20 participants times $5, or $100. That represents only the cap *for each participant*. The cap *for the plan* is that same $100 multiplied by 20 participants, or $2,000. One needs to think of the cap *on a plan-wide basis* as $5 times the *square of the participant count*.

PBGC's proposed rule addressed several interpretive issues relating to the new VRP cap.

A. Plans Covered

Although the statutory language in one place refers simply to ''the case of *an employer* who has 25 or fewer employees on the first day of the plan year'' (emphasis added), in another place it provides that, ''[i]n the case of a plan maintained by two or more contributing sponsors, the employees of all contributing sponsors and their controlled groups shall be aggregated for purposes of determining whether the 25-or-fewer-employees limitation has been satisfied.'' PBGC concluded that ''the applicability of the cap must be determined plan by plan, not employer by employer.''[46] Thus, in the case of a multiple-employer plan with one or more unrelated employers who themselves have 25 or fewer employees, the cap does not appear to be available unless there are 25 or fewer employees taking into account all contributing sponsors and all controlled group members.

B. Meaning of 'Employee'

The statutory language refers to ''employees'' for purposes of the ''25-or-fewer-employee'' test, but does not provide any guidance on who counts as an employee. PBGC proposed to define ''employee'' for this purpose by reference to the minimum coverage rules for qualified plans, explaining its proposal as follows:

> New section 4006(a)(3)(H) of ERISA does not give guidance as to the meaning of the term ''employee.'' PBGC proposes to define ''employee'' for this purpose by reference to section 410(b)(1) of the Internal Revenue Code, which deals with minimum coverage requirements for qualified plans and requires that employees be counted to evaluate the breadth of coverage of a plan. For this purpose, certain individuals may be counted as ''employees'' although they might not be considered common law employees of the employer—for example, affiliated service group employees (under Code section 414(m)) and leased employees (under Code section 414(n)). PBGC considers this approach appropriate to prevent an employer from qualifying for the cap by artificially lowering its employee count through the use of sophisticated business structuring devices. In addition, in order to ensure that all employees are counted, PBGC proposes that the employee count be determined without regard to Code section 410(b)(3), (4), and (5), which might be considered to exclude from the count collective bargaining employees, employees not meeting a plan's age and service requirements, and employees in separate lines of business.[47]

The use of this relatively broad definition of ''employees'' will no doubt serve to limit the availability of the cap.

C. Computation of Cap

PBGC noted that the statutory provisions define the per-participant cap as ''$5 multiplied by the number of participants in the plan *as of the close of the preceding plan year*'' (emphasis supplied). The preamble stated that ''PBGC interprets this to mean that the participant count is to be taken as of the premium snapshot date described in the premium rates regulation and PBGC's premium instructions (*generally* the last day of the plan year preceding the premium payment year)'' (emphasis supplied), *i.e.*, the same participant count ''as the count used as a multiplier'' for the single-employer flat-rate premium generally.[48]

V. Comments on Proposed Rule

Comments on PBGC's proposed rule must be submitted on or before April 23, 2007. For instructions on the methods available for commenting, see the preamble to the proposed rule at http://www.pbgc.gov/docs/E7-2812.pdf.

VI. Conclusion

PBGC premiums are changing and, following some relief for the 2007 plan year, are likely to move higher for all plans in terms of the flat-rate premium and for many plans in terms of the VRP. Understanding the ever-changing premium rules will help practitioners properly advise their clients in this area of ever-increasing complexity and importance.

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[46] 72 Fed. Reg. at 7756.

[47] *Id.*

[48] *Id.*

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