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A Practical Guide to Dealing with PBGC Issues

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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

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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)

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

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Standard Terminations: Form 500 Filing (Cont.)

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

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Standard Terminations: PBGC Review

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

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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/late 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 90th 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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