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SPECIAL REPORT

PBGC Implements Flat-Rate Premium Increase, Termination Premium, and Small Employer VRP Cap

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 changed for the 2007 plan year, with a complete overhaul going 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.

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Over the past year, PBGC has issued significant guidance on several of these premium changes in the form of two technical updates, two proposed rules, and—most recently—a final rule:

- *Technical update 07-1*. 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 (2006 and 2007 changes)*. On Feb. 20, 2007, PBGC published a proposed rule that would implement 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

[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.

a new cap on the VRP for small employers that went into effect starting with the 2007 plan year.[2]

■ *Proposed rule (2008 changes)*. On May 31, 2007, PBGC published a proposed rule that would, among other things, implement provisions of the Pension Protection Act of 2006 (''PPA'') that change the VRP starting with the 2008 plan year. These changes 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.[3] A final version of this proposed rule is still to come.

■ *Technical update 07-2*. On Nov. 28, 2007, PBGC issued Technical Update 07-2 (''Funding-Related Determinations for Reporting Under Parts 4010 and 4043; Effect of the Pension Protection Act of 2006; Transitional Guidance'') to provide guidance on the applicability of the changes made by PPA and the corresponding proposed PBGC regulatory changes to the determination of funding-related amounts for purposes of PBGC's annual employer reporting regulation (29 CFR Part 4010) and reportable events regulation (29 CFR Part 4043, Subparts A-C).[4]

■ *Final rule (2006 and 2007 changes)*. On Dec. 17, 2007, PBGC published a final rule implementing 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 went into effect starting with the 2007 plan year.[5]

This article focuses on the recently-issued final rule implementing statutory changes that went into effect starting in 2006 and 2007. The final rule adopts, with only minor editorial changes, the regulatory language PBGC proposed. Only one comment was submitted in response to the proposed rule. That comment, which suggested that PBGC adopt a settlement policy regarding the new termination premium, is discussed in Part II.F. of this article.

I. 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);[6] the recently-announced 2008 rates will be $33 for single-employer plans (rounded up from $32.53) and $9 for multiemployer plans (rounded up from $8.67).[7]

PBGC's final rule in most respects simply incorporates the statutory language into its premium regulations. However, the preamble to the final 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.''[8]

■ *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).''[9]

■ *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.''[10]

II. 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.[11] This new termination premium, or ''exit

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

[3] The proposed rule, published at 72 Fed. Reg. 30308, is available at http://www.pbgc.gov/docs/E7-10412.pdf.

[4] Technical Update 07-2, which was issued (as noted) on Nov. 28, 2007, and revised on Dec. 7, 2007 (corrected Dec. 15, 2007), is available at http://www.pbgc.gov/practitioners/law-regulations-informal-guidance/content/tu16267.html.

[5] The final rule, published at 72 Fed. Reg. 71222, is available at http://www.pbgc.gov/docs/E7-24423.pdf.

[6] 71 Fed. Reg. 69602 (Dec. 1, 2006).

[7] 72 Fed. Reg. 67765 (Nov. 30, 2007).

[8] 72 Fed. Reg. at 71223.

[9] *Id.*

[10] *Id.*

[11] 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

   ISSN 1069-5117

fee" as some call it, is a hefty one: $1,250 per participant, per year, for three years.[12] 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,[13] the "inability to continue in business" test,[14] or the "unreasonably burdensome pension costs" test,[15] but *not* the "liquidation" test[16]) 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 final 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.[17] 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."[18]

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 final 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.[19]

Under the final rule, *each* contributing sponsor and *each* controlled group member (determined as of the day before the termination date) is responsible for 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."[20] The final rule also places recordkeeping responsibilities with respect to the new termination pre-

"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.

[12] 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).

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

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

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

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

[17] 72 Fed. Reg. at 71224.

[18] *Id.* at 71225.

[19] *Id.*

[20] *Id.* at 71226.

mium on *each* contributing sponsor and *each* controlled group member.[21]

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.[22]

The preamble also addressed how the termination premium due date rules would work where (as is common) the establishment of the termination date takes place well after the date so established.[23] 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 set is in the past, 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.[24] In the final 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.[25]

This flexibility will 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. Settlement Policy

The one comment submitted in response to PBGC's proposed rule focused on the settlement issue. Expressing concern that "Congress may not have considered the financial ramifications of" the termination premium, the commenter requested that PBGC "adopt a facts-and-circumstance approach in collecting the termination premium fee" and "consider limiting its recoveries of this termination premium to amounts that each company can afford to pay without jeopardizing its ability to stay in business." [26]

PBGC's response suggests that it will be proceeding with some caution in settling its termination premium claims:

> PBGC has accepted less than full payment on its claims for unfunded benefit liabilities, unpaid funding contributions, and unpaid flat- and variable-rate premiums in circumstances in which, like other creditors, it is forced to compromise those claims. But the language of section 8101(b) of DRA 2005 makes clear that a Congressional purpose in imposing the termination premium was to discourage the termination of underfunded pension plans. Congress has made clear that, when a plan terminates under the circumstances described in new section 4006(a)(7)(B) of ERISA during the pendency of a bankruptcy reorganization, the liability for the termination premium arises after emergence from bankruptcy, indicating a specific intent to avoid a limited recovery of the termination premium in bankruptcy and to ensure a full recovery post-bankruptcy. In light of this Congressional intent, it would be inappropriate for PBGC to adopt a policy of routinely settling termination premium claims for less than the full amount.
>
> PBGC recognizes that plan sponsors may face difficult financial choices because of the termination premium. Accordingly, PBGC encourages sponsors that may be facing termination premium liability to contact PBGC as early as possible to discuss.[27]

PBGC's approach to settlement will have a major effect on how significant an issue the termination premium becomes. Although PBGC has left the settlement door open, the circumstances in which, and the extent to which, PBGC will be willing to settle remain to be seen. For now, there is a threshold issue whether the termination premium will hold up in court in the bankruptcy context; in at least one case, a challenge has

[21] *Id*. at 71229 (§ 4007.10(a)(3)(ii)).
[22] *Id*. at 71226.
[23] *Id*.
[24] *See* 29 CFR § 4007.8.
[25] 72 Fed. Reg. at 71227.
[26] *Id*.
[27] *Id*.

   ISSN 1069-5117

been mounted on the basis that the termination premium is, in effect, a pre-petition general unsecured claim that has been discharged in bankruptcy.[28] Moreover, it is possible—particularly if the termination premium *does* hold up in court— 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.

The bottom line is that we will have to await developments in the courts, actions by Chapter 11 debtors, and actions by PBGC before we will know whether the new termination premium will end up being as significant as the sheer numbers suggest.

III. 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 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 final 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."[29] 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." New Sec. 4006.3(b)(4) as added by this rule defines "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, new Sec. 4006.3(b)(4) provides that the employee count is to 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.[30]

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.[31]

IV. Effective Date and Applicability of Final Rule

The final rule carries an effective date of January 16, 2008, *i.e.*, the usual 30-day delayed effective date under

[28] *Oneida Ltd. v. PBGC*, Adversary Proceeding #06-01920-alg in Case No. 06-10489 (Bankr. S.D.N.Y).

[29] 72 Fed. Reg. at 71224.
[30] *Id.*
[31] *Id.*

the Administrative Procedure Act. However, the final rule by its terms applies retroactively. The provisions relating to the flat-rate increase apply starting with the 2006 plan year; those relating to the termination premium apply to plans with termination dates on or after January 1, 2006 (subject to the special rule for bankruptcies filed before October 18, 2005); and those relating to the small employer VRP cap apply starting with the 2007 plan year.

V. Conclusion

PBGC premiums 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.

   ISSN 1069-5117