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together

Plan Sponsor Basics Webinar Series

Pension Benefit Guaranty Corporation Issues
for Pension Plan Sponsors

Webinar 4 of 5

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Scope of Discussion

- This webinar reviews issues related to single-employer defined benefit pension plans subject to Title IV of ERISA.
- We will focus on four topics involving PBGC regulation of single-employer plans under Title IV:
  – The PBGC's Early Warning Program
  – Enforcement of ERISA Section 4062(e)
  – Reporting Requirements
  – Bankruptcy/Restructuring

PBGC Early Warning Program

- PBGC monitors corporate transactions and may seek to intervene if it believes risk to pension plan, and thereby to PBGC's future insurance liability, will increase.
  - Monitors press reports and other publicly available information to identify transactions.
  - Focuses on negative impact on plan sponsor controlled group's creditworthiness, decreasing PBGC recovery prospects in subsequent plan failure and plan sponsor bankruptcy,

    OR

  - Looks into whether capital restructuring increases plan sponsor's secured debt, with similar threat to future PBGC recovery.

PBGC Early Warning Program (cont.)

- No specific statutory or regulatory authority for Early Warning Program.
  - PBGC cites ERISA section 4042(a)(4), authorizing involuntary plan termination if PBGC determines that “possible long-run loss of [PBGC]…may reasonably be expected to increase unreasonably if the plan is not terminated.” PBGC Technical Update 00-3 (7/24/2000).
  - Nuclear option is PBGC’s <u>only</u> leverage; must bring civil action in federal court for involuntary plan termination.

PBGC Early Warning Program (cont.)

- Joint and several controlled group liability for plan termination.
  - PBGC will attempt to establish plan termination date prior to transaction closing date, so pretransaction controlled group is on the hook, and PBGC may attempt to claim pretransaction priority.
  - May have *in terrorem* effect on lenders and other parties to transaction.

PBGC Early Warning Program (cont.)

- Criteria for targeting transaction:
  - Controlled group has pension plans with aggregate underfunding of $50 million or more

    OR

  - Controlled group has pension plans with 5,000 or more participants in the aggregate.
- Criteria for analysis:
  - Post-transaction controlled group's ability to afford plan.
  - Likelihood that PBGC will be able to collect if things go south.
  - Overall effect on PBGC's insurance risk.

PBGC Early Warning Program (cont.)

- PBGC may only request additional information.

  OR

- PBGC may seek to negotiate:
  - Accelerated contributions
  - Letters of credit
  - Escrow accounts
  - Surety bonds
  - Guarantees by departing controlled group members
  - Credit default swaps

PBGC Early Warning Program (cont.)

OR

- PBGC may determine that the plan should be terminated and bring an enforcement action in federal court ("nuclear option").
  - Historically, nuclear option has rarely been invoked.
  - More aggressive in 2012 and 2013.
  - Civil actions all settled.
  - Recent negative litigation experience (despite PBGC website announcement to the contrary) may cause PBGC to be more cautious in future.

Enforcement of ERISA Section 4062(e)

- What is 4062(e) and why is it important?
  - Little-noticed (for years) section of ERISA.
  - Designed to provide security to PBGC and the plan when the sponsor of an underfunded single-employer plan closes a plant employing a significant number of active plan participants.
    - *Why? Because plant closing reduces the revenue stream that presumably supports pension funding by the sponsor in whole or in part and creates risk of a distress termination (PBGC assumption of liability, loss of participant benefits).*

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Enforcement of ERISA Section 4062(e) (cont.)

- What are the elements of a 4062(e) event?
  - Employer “ceases operations at a facility in any location.”
  - As a result, more than 20% of active employees who are participants in a single-employer plan are separated from employment.
    - *Need not be accruing benefits, just employed*
  - Deceptively simple; devil is in the details (more in a minute).

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Enforcement of ERISA Section 4062(e) (cont.)

- How does it work?
  - ERISA treats a 4062(e) event as if it were the withdrawal by a substantial employer from a "multiple employer" plan.
  - Triggers the operation of provisions in ERISA Section 4063 requiring the sponsor to (i) report the event and (ii) provide security in the form of a bond or escrow payment.
  - Amount of bond or escrow payment is tied to the amount of underfunded termination liability of the plan, determined using PBGC (conservative) assumptions.
    - *Amount of underfunding is multiplied by the percentage drop in number of active (employed) participants caused by the shutdown.*

Enforcement of ERISA Section 4062(e) (cont.)

- Employer is required to provide a written notice to PBGC of a 4062(e) event within 60 days (per Section 4063(a)).
  - No exemptions for small plans, funding, etc.
- Event may also be a separate reportable event under ERISA Section 4043 (e.g., active participant reduction); reporting required within <u>30</u> days.
  - May be subject to regulatory reporting exemptions.
- If reportable under both, can make a single combined filing.
- PBGC often learns on its own under Early Warning Program.

Enforcement of ERISA Section 4062(e) (cont.)

- Once the 4062(e) amount is determined, PBGC can require that the sponsoring employer:
  - Place the amount in cash in an escrow account, or
  - Post a bond equal to up to 150% of the amount.
- Bond or escrow must remain in place for five years after the 4062(e) event.
- PBGC can draw on the bond or escrow if the plan incurs a distress termination within that five-year period to cover any underfunding.
- If no distress termination, escrow is returned (without interest) or bond cancelled.

Enforcement of ERISA Section 4062(e) (cont.)

- **Example**: Employer closes Plant, which employs 200 active employees. Employer sponsors a frozen defined benefit plan that only covers active and former employees of Plant. The plan covers the 200 actives, 1,500 deferred vested employees, and 5,000 retirees. Its total underfunding on a PBGC termination basis is $100 million.
  - Section 4062(e) would allow PBGC to require Employer to put $100 million into an escrow account or post a $150 million bond for five years (ouch).

Enforcement of ERISA Section 4062(e) (cont.)

- PBGC has the authority to waive this requirement in lieu of other ways of providing security (and routinely does so).
  - Posting a letter of credit to cover the 4062(e) amount
  - Requiring that the employer provide a lien (typically subordinated) on employer assets in favor of the plan
  - Requiring that the employer waive any use of a prefunding balance in determining its minimum funding
  - Requiring extra contributions in addition to the minimum (with contributions not being credited to a prefunding balance)

Enforcement of ERISA Section 4062(e) (cont.)

- Roller Coaster Ride
  - From 1974 (ERISA) through 2006, rarely enforced (mainly because of lack of PBGC guidance); off the radar screen, even during the many plant closings in the ’80s (steel, auto).
  - PBGC published guidance regarding how to determine the 4062(e) amount in 2006, and then began aggressive enforcement in 2007.
    - *Since 2007, PBGC has settled more than 130 cases totaling about $1.7 billion in 4062(e) liability, including $155 million in fiscal 2013.*

Enforcement of ERISA Section 4062(e) (cont.)

- However, arguably, PBGC overplayed its hand.
  - Applied Section 4062(e) even in cases where it didn't make policy sense (e.g., small plans with modest underfunding; solvent, large employers).
  - Used conservative termination liability assumptions that didn't square with Tax Code funding or accounting numbers.
  - Proposed regulations in 2010 with some extreme positions (e.g., Section 4062(e) applied if a discrete "operation" ceased, even if other operations at the facility continued or work was transferred; triggered by a sale of assets even if the buyer continued operations and assumed the plan; triggered by a temporary cessation).

Enforcement of ERISA Section 4062(e) (cont.)

- Major backlash among employer/business advocates on Capitol Hill and in comments to PBGC.
- Two significant results:
  - PBGC backtracks
    - *Has not finalized 2010 regulations.*
    - *Announced new enforcement guidelines in 2012 exempting small plans (under 100 participants) and "creditworthy/financially strong employers" (though with significant PBGC discretion).*
    - ***Announced on July 8, 2014 a moratorium on enforcement through December 31, 2014 (reporting still required) while potential additional tightening of enforcement parameters considered.***

Enforcement of ERISA Section 4062(e) (cont.)

- Second result: Congress acts! (Not a typo)
  - On September 16, 2014, Senate unanimously (!) passed a bill amending Section 4062(e).
    - *Requires a "permanent" cessation of all operations at the entire facility.*
    - *Only triggers if the cessation causes a 15% reduction in the employer's entire workforce.*
    - *Won't apply if plan is 90% funded (using PBGC variable-rate premium assumptions, which are more consistent with market).*
    - *Won't apply if jobs replaced at another U.S. facility.*

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Enforcement of ERISA Section 4062(e) (cont.)

- *Won't apply if buyer acquires facility, hires employees, and assumes pension assets and liabilities.*
- *Provides an alternative to bond/escrow (basically, accelerated funding of the underfunded liability attributable to the facility's closing over seven years).*

– May well be passed by the House (and signed by the President) during lame-duck term; strong bipartisan support.

- Bottom Line: For now, Section 4062(e) = wait and see; continue reporting, look for congressional action, and see what happens between now and December 31, 2014.

New Reporting Requirements

- PBGC proposed September 23, 2014 to require plan sponsors to provide additional information regarding "de-risking activities" with premium filings, beginning in 2015.
  - New lump-sum cash-out options, including lump-sum windows.
  - Group annuity contracts for specified groups of former employees.
- Those actions will decrease future PBGC premiums, but also potential PBGC liabilities.

New Reporting Requirements (cont.)

  - Why does PBGC want to know? For what purpose will PBGC use the new information?

- PBGC is requesting comments on whether the information is necessary to PBGC's performance of its responsibilities, including whether the information will have practical utility.

Proposed Reportable Event Regulations

- New waivers of reporting requirements-based plan or plan sponsor financial soundness.
  - Plan sponsor financial soundness:
    - *Credit report score from recognized credit reporting organization, indicating low likelihood of default on debt*
    - *Positive net income*
    - *No secured debt, except purchase-money mortgages and leases*
    - *No loan defaults*
    - *No missed pension contributions, except quarterly contributions for which reporting is waived*

Proposed Reportable Event Regulations (cont.)

- Plan financial soundness:
  - 100% funded on termination basis or 120% funded on premium basis
- Events to which financial soundness waivers apply:
  - Extraordinary dividend/stock redemption
  - Change in contributing sponsor or controlled group (applied to post-transaction group)
  - Active participant reduction
  - Transfer of benefit liabilities
  - Distribution to substantial owner

Proposed Reportable Event Regulations (cont.)

- Other notable proposed changes:
  - Small plan waiver (less than 100 participants):
    - *Current: active participant reduction*
    - *New:*
      - Controlled group changes
      - Benefit liability transfers
      - Extraordinary dividends

Proposed Reportable Event Regulations (cont.)

- Foreign entity and *de minimis* percentage of controlled group waivers
  - Loan default
  - Liquidation
  - Nonbankruptcy insolvency
  - Extraordinary dividend/stock redemption
  - Controlled group change

Proposed Reportable Event Regulations (cont.)

- Active participant reduction: triggered only if threshold crossed within single 30-day period or by a single cause.
- Loss of controlled group member by internal merger excluded.
- Bankruptcy Code bankruptcies excluded.

PBGC in Bankruptcy/Restructuring

- Under current version of Title IV, only way an employer can effect a distress termination of a single-employer plan is in bankruptcy.
- For an employer with significant legacy liabilities (pension and retiree medical) that are dragging down the business, Chapter 11 offers a potential avenue for either (i) restructuring debt, shedding pension and retiree medical liabilities, and continuing to operate or (ii) selling the business as a going concern free and clear of those liabilities.

PBGC in Bankruptcy/Restructuring (cont.)

- BUT: This leaves PBGC holding the bag – and PBGC does not like to be left holding the bag.
  - PBGC itself has a substantial deficit (well over $20 billion by its estimates) as the result of assuming underfunded plans.
  - PBGC is not taxpayer financed; its funds come from premium payments, assets of plans it takes over, and the collection of liability from employers.
  - Premiums have been increasing, but not fast enough for PBGC.
  - De-risking activities are reducing premium stream.

PBGC in Bankruptcy/Restructuring (cont.)

- PBGC has tried to take an active role in bankruptcy proceedings as a creditor to protect its and the plan's interests.
  – PBGC is generally entitled to its own seat on the creditors' committee; may demand an independent fiduciary for the plan.
  – Will advocate hard in bankruptcy court for company that is being restructured to retain its plan post-bankruptcy; has had some success.
  – Will try to claim priority status for some or all of its claims and will argue that its method of determining underfunding should be used in determining the size of its claims.

PBGC in Bankruptcy/Restructuring (cont.)

- However, bankruptcy courts have been less than friendly to PBGC in many cases.
  - Have generally rejected PBGC attempts to classify its claims as anything other than general unsecured claims.
    - *PBGC tries to get liens prebankruptcy to prevent this (e.g., for missed minimum funding), but law makes it difficult to do before petition filed and automatic stay attaches.*
  - Have often disagreed with PBGC on size of claim.
  - Recent case (<u>Ormet</u>) affirms ability to sell assets free of pension liabilities under Section 363(f) of Bankruptcy Code.

PBGC in Bankruptcy/Restructuring (cont.)

- Therefore, in addition to taking action under Early Warning System or Section 4062(e) to improve its position in advance of bankruptcy, PBGC will aggressively pursue claims against potential nonbankrupt parties that may be jointly and severally liable.
  - Nonfiled members of controlled group (including foreign entities)
  - Predecessors where there may be grounds for “evade” liability under Section 4069(a)

PBGC in Bankruptcy/Restructuring (cont.)

- PBGC position may be bolstered by recent decision in the Sun Capital case (i.e., upholding claim by multiemployer plan that a private equity firm's investment fund could be deemed a "trade or business" that is part of a controlled group with a bankrupt portfolio company).

PBGC in Bankruptcy/Restructuring (cont.)

- New PBGC "weapon": exit fee if plan is terminated in bankruptcy and employer reorganizes, emerges from bankruptcy.
  - $1,250 per participant per year (three-year period).
  - Oneida case: Obligation is not discharged in bankruptcy.
  - BUT: Can be thwarted by allowing for a 363(f) sale of assets to a purchaser, followed by a liquidation of the bankrupt employer, even if there may be some preexisting relationship between purchaser and the bankrupt company (e.g., purchaser was a significant creditor of company and bids the debt for assets).

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PBGC in Bankruptcy/Restructuring (cont.)

- *Bottom line*: If a company that is financially distressed has an underfunded single-employer pension plan and is considering its options, it is critical to involve benefits counsel experienced with PBGC claims in bankruptcy.

Questions?

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