

ERISA Reins in PBGC

Change affects sale or shutdown of a DB plan sponsor



Defined benefit (DB) plan sponsors contemplating the sale or shutdown of a facility need to be aware of recently enacted changes to Section 4062(e) of the Employee Retirement Income Security Act (ERISA). Until President Barack Obama signed the amending legislation on December 16, 2014, this provision, in less than 90 words, created potential sponsor liability when cessation of operations at a facility resulted in loss of jobs by more than 20% of the employees covered by the sponsor's pension plan.

As interpreted by the Pension Benefit Guaranty Corporation (PBGC), the old law provided a formula by which this liability was determined under conservative agency termination liability rules. Termination liability determined in this manner was multiplied by the ratio of terminated active participants to all active participants. This created significant liability for many pension plans, but frozen plans were particularly affected, as a large ratio resulted from those plans' small number of active participants.

Under the amended section, a cessation of operations at a facility triggering liability occurs if it results in more than a 15% reduction in the total number of employees eligible to participate in any employee pension benefit plan sponsored by the company. While the old trigger was a fraction greater than 20%, its denominator consisted only of defined benefit plan participants and was therefore much narrower. A larger denominator means it will be harder to trigger liability.

Calculation of the work force reduction under the new statute excludes separated employees who have been replaced by another employee at a new location, as long as the new work location is in the U.S. Further, employment reductions resulting from the sale of a facility will not be counted if the new owner retains or replaces separated employees.

Two Exemptions

The amended version of Section 4062(e) also incorporates two significant exemptions. First, small plans with fewer than 100 participants are not subject to liability, even if there is a cessation of operations at a facility. In addition, plans that were at least 90% funded in the plan year before the cessation occurred are exempt.

If liability under Section 4062(e) is triggered, it can be met, as before, by providing financial security to protect the plan in the form of a bond or escrowed funds placed with the PBGC. The amended statute adopts existing PBGC enforcement policy by giving plan sponsors the option to satisfy this liability through additional plan contributions deter-

mined under rules similar to the regular funding rules. The methodology for determining the amount of these contributions is designed to reduce the sponsor's cost. Accordingly, the sponsor may contribute seven annual installments equal to one-seventh of the plan's unfunded vested benefits. These payments are capped so they will not increase the plan's minimum funding contributions. The annual installments are discontinued if the plan attains a 90% funding level, even if it subsequently falls below that threshold.

If the 15% reduction described above occurs, thereby triggering liability under Section 4062(e), the plan sponsor must report the event to the PBGC. This does not apply if the plan qualifies for the small plan or 90% funding exemption. Plan sponsors that wish to meet their Section 4062(e) liability by making plan contributions must notify the PBGC of their election no later than 30 days after the earlier of: 1) the date the sponsor notifies the agency that a 15% work force reduction has occurred, or 2) the date the PBGC makes such a determination. Further, the sponsor must notify the PBGC of each of the seven additional plan contributions, no later than 10 days after the payment, and also of a failure to make any of these contributions by the 10th day after the due date.

The PBGC's enforcement policy since 2012 has been that it will not initiate action under Section 4062(2) against financially strong plan sponsors. This policy is being carried forward. The test for a company's financial strength is: 1) unsecured debt-equivalent ratings from both Moody's and Standard & Poor's (S&P) of at least Baa3 by Moody's and BBB- by S&P; 2) a company rating by Moody's or S&P of Baa3 or BBB-, respectively; or 3) if the company is not rated by Moody's or S&P, a D&B Financial Stress Score of at least 1,477 and secured debt—other than debt incurred to purchase real estate and equipment—not exceeding 10% of its asset value.

Provided the conditions therein are satisfied, the new legislation and the PBGC's enforcement policy with respect to financially strong companies should eliminate much of the uncertainty plan sponsors have had over whether a plant closing or sale may result in liability under Section 4062(e).

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