MERCER
MAKE TOMORROW, TODAY

LAW & POLICY GROUP

GRIST

PBGC PROPOSAL SQUASHES SPIN-TERMS, INCLUDES GRAB BAG OF OTHER CHANGES

By Mercer's Brian Kearney and Margaret Berger
July 2, 2019

In This Article

Premiums | Reportable Events | 4010 Filings | Standard Terminations | Comments Requested | Effective Date | Related Resources

Recently proposed PBGC regulations would make a host of changes to the agency's rules on premiums, standard terminations, reportable-event filings and ERISA Section 4010 filings. Notably, the regulations would cement PBGC's opposition (as announced last year) to the popular "spin-term" variable-rate premium (VRP) reduction strategy. The rules would eliminate another popular strategy for reducing flat-rate premiums (FRPs) using a *de minimis* spinoff exemption. This article highlights the proposed changes and clarifications. Comments are due by Aug. 26.

PREMIUMS

Along with curtailing the use of spinoffs to reduce premiums, the proposed rules clarify how to apply the special rule that shifts the participant count date for FRPs when a plan undergoes a merger or spinoff that's not *de minimis*.

Opposition to Spin-Term VRP Reduction Strategy Formalized

Under existing PBGC regulations, a terminating plan owes no VRP in the year it distributes all assets. Some plan sponsors have used this exemption to reduce their VRP by spinning off a portion of an existing plan and terminating the original plan (popularly called a "spin-term"). If the original plan's assets are distributed in that same plan year, no VRP is owed for that plan, and only a pro-rated VRP is due for the spun-off plan.

PBGC resistance to spin-term strategy. Under last year's revised premium filing instructions, the terminating-plan exemption applies only if, by year-end, "benefits for participants covered by the plan on the UVB Valuation Date will be distributed in accordance with PBGC's standard termination regulation," thereby ending PBGC coverage of those benefits. PBGC added this language to clarify its position that the exemption does not apply in a year when participants have been spun off to another plan. This change reinforced earlier informal guidance saying PBGC was "especially skeptical" about the spin-term strategy.

COPYRIGHT 2019 MERCER LLC. ALL RIGHTS RESERVED.

MARSH & McLENNAN COMPANIES

Proposal cements PBGC's opposition. The proposed rule would codify PBGC's earlier guidance, eliminating the VRP exemption if a terminating plan engages in a spinoff that's not *de minimis* during the premium payment year. (In a *de minimis* spinoff, less than 3% of the plan's assets are transferred, and the amount of assets transferred equals the present value of accrued benefits spun off. But a sponsor can't work its way around the rule by making a series of smaller spinoffs, each under 3% — multiple small spinoffs in a given year generally are consolidated for the *de minimis* determination.)

No proration of flat-rate premiums. The regulations currently permit prorating FRPs in a short plan year that is a terminating plan's final plan year. The proposed regulations would prohibit this proration if the plan earlier in the year engaged in a spinoff that was not *de minimis*.

Participant Count Date

FRPs for a plan year are based on the number of participants on the "participant count date," which is generally the last day of the plan year before the premium payment year. Changes in the participant count during the plan year do not affect that year's flat-rate premium. But a special rule shifts the participant count date to the first day of the plan year when a merger or spinoff that's not *de minimis* takes place at the beginning of a plan year, so the change is recognized for that year's FRP.

Plan-to-plan transfers. When a portion of a plan is spun off at the beginning of the year, the special rule changes the participant count date for the transferring plan. If the receiving plan is a new plan, its participant count date is automatically the first day of the plan year, so both plans use the same date and participants would be counted only once — in the receiving plan. If the receiving plan is an existing plan and the second half of the transaction is viewed as a merger, the special rule would also change the participant count date to the first day of the plan year.

Some practitioners have interpreted the premium filing instructions to provide that the special rule doesn't apply if the receiving plan is an existing plan. (This interpretation presumably arises because the instructions define a merger to involve the transfer of all — not just some — assets and liabilities.) In that case, the transferred participants would be disregarded by both the transferring plan (with a beginning-of-year participant count date) and the receiving plan (with a participant count date at the end of the previous year). The proposed rules would clarify that the special rule would operate for both the transferring and receiving plan in the case of a plan-to-plan transfer.

Mergers. The special rule also applies to the ongoing plan in the case of a beginning-of-year merger that's not *de minimis*. For example, if two calendar-year plans merge at the beginning of 2020, the surviving plan's participant count date for the 2020 premium year shifts to Jan. 1, 2020. As a result, the surviving plan owes a 2020 FRP for all participants.

De minimis mergers are exempt from this special rule, which means that the FRP calculation excludes the transferred participants. This is because the surviving plan's participant count date remains the last day of the previous plan year, and the disappearing plan ceases to exist on the first day of the plan year, so that plan owes no premiums. Practitioners asked PBGC whether the *de minimis* exemption applies when the surviving plan is the smaller plan. If so, a plan sponsor could avoid paying the FRP for the large plan

COPYRIGHT 2019 MERCER LLC. ALL RIGHTS RESERVED.

simply by merging it into a much smaller plan. The proposal would clarify that the *de minimis* exception applies only when a small plan merges into a large plan.

REPORTABLE EVENTS

The proposal notes that PBGC has identified opportunities to improve the reportable-event and notification requirements by filling in gaps in existing guidance, simplifying or removing language, codifying policies, and providing examples.

Changes and Clarifications to Events

The proposal would change or clarify the requirements for event reporting as summarized below.

Active participant reduction. Unless a waiver applies, sponsors must report active participant reductions on Form 10 when the participant count falls below the reporting threshold. Under current regulations, the threshold is the higher of 80% of the number of participants at the beginning of the current plan year or 75% of the number of participants at the beginning of the prior plan year. The reduction can be due to a single-cause event, such as a reorganization or a layoff, or routine attrition. A single-cause event requires reporting within 30 days after the event causing the reduction. An attrition event requires reporting by the sponsor's premium filing deadline for the plan year after the year in which the attrition event occurs.

The proposal would make several changes to the rules for an active participant reduction:

- ***Change to the 80% threshold.*** The proposal will change the measurement of the 80% threshold. Rather than requiring reporting when the participant count falls below 80% of the beginning-of-year number, the proposal would require reporting when an event causes a participant reduction exceeding 20% of the beginning-of-year number. This change will make it easier to apply the rules when multiple events happen in a single year.

- ***Elimination of 75% two-year lookback threshold.*** The requirement to compare the year-end participant count to the prior year's starting participant count would be eliminated by means of an automatic waiver.

- ***No double-reporting of single-cause and attrition events.*** Already-reported reductions due to a single-cause event would be disregarded when determining whether an attrition event has occurred. This change would formalize earlier informal guidance from PBGC in Technical Update 17-1 and the 2018 Enrolled Actuaries (EA) Blue Book, Q&A-8.

- ***Multiple single-cause events.*** The proposal would clarify that multiple single-cause events occurring in the same year require separate reporting.

- ***Definition of an active participant.*** The proposal would clarify that a participant is considered active if the participant receives compensation from any member of the plan's controlled group for work performed anywhere in the controlled group.

COPYRIGHT 2019 MERCER LLC. ALL RIGHTS RESERVED.

- ***4062(e)/4063(a) reporting.*** The proposal would clarify that an active participant reduction needn't be reported on the Form 10 if the sponsor has already reported the reduction to PBGC as part of an ERISA Section 4062(e) plant-shutdown notice or Section 4063(a) notice of withdrawal of a substantial employer from multiple-employer plan.

Inability to pay benefits when due. In general, a plan's failure to make a benefit payment on time is a reportable event. But current regulations don't require reporting if the failure is caused by an "administrative delay, including the need to verify a person's eligibility for benefits, to the extent that the delay is for less than the shorter of two months or two full benefit payment periods." Recognizing that employers may need more time to verify benefit eligibility, the proposal would amend this provision to eliminate the time limit when the delay is solely to verify eligibility.

Change in contributing sponsor or controlled group. A change in the plan's controlled group — for example, when a subsidiary is sold or the plan moves to a new controlled group — is a reportable event. However, an exception applies for a "reorganization involving a mere change in identity, form, or place or organization." Under the existing regulations, the heading to the description of this event mentions changes to both the contributing sponsor and the controlled group, but the actual text mentions only changes in the controlled group. The proposal would clarify that reporting is required for both, but that the reporting exception would not apply if the contributing sponsor were the entity undergoing reorganization.

Liquidation. PBGC's regulations currently provide that "a reportable event occurs for a plan when a member of the plan's controlled group—

(1) Is involved in any transaction to implement its complete liquidation (including liquidation into another controlled group member);

(2) Institutes or has instituted against it a proceeding to be dissolved or is dissolved, whichever occurs first; or

(3) Liquidates in a case under the Bankruptcy Code, or under any similar law."

The proposal would rewrite number (1) above to read as follows:

(1) Resolves to cease all revenue-generating business operations, sell substantially all its assets, or otherwise effect or implement its complete liquidation (including liquidation into another controlled group member) by decision of the member's board of directors (or equivalent body such as the managing partners or owners) or other actor with the power to authorize such cessation of operations, sale, or a liquidation, unless the event would be reported under paragraph (a)(2) or (3) of this section."

Clarity on reporting trigger. This change is meant to bring greater clarity and precision to what it means to be involved in a liquidation event and when the event is triggered. Importantly, the proposal says it's the *decision* to cease revenue-generating business operations that triggers reporting. In most cases, the

COPYRIGHT 2019 MERCER LLC. ALL RIGHTS RESERVED.

liquidation decision will occur through a formal approval or authorization process. But even when the sponsor is a company with a single-person owner and no board formalities, PBGC says there is a moment when the owner makes the decision to liquidate. The phrase "cease revenue-generating business operations" makes clear the reporting trigger is a decision that will result in the company not earning the revenue needed to continue supporting its pension plan. Administrative activities after revenue stops, as part of the winding-down process, will not delay the time when a liquidation event is deemed to occur.

Filing deadline extended for public companies. PBGC does not intend to compel public companies to disclose liquidations on Form 10 before notifying the public. So the proposal would extend the Form 10 filing deadline for public companies until the earlier of the timely filing of an SEC Form 8-K disclosing the liquidation or the issuance of a press release discussing it.

No double reporting when liquidation is due to insolvency. Companies that liquidate as a result of insolvency have two reportable events: a liquidation event and an insolvency event. Given the similarities between the two events, the proposal includes a new waiver that would provide relief from duplicative reporting for liquidation and insolvency.

Clarification of Low-Default-Risk Waiver

The low-default-risk waiver (called the "commercial measures waiver" in the proposal), is available for certain reportable events and applies when a sponsor has "adequate capacity to meet its obligations." The sponsor must satisfy a combination of certain criteria, including that the probability of default on its financial obligations is no more than 4% over the next five years or 0.4% over the next year. This probability must be "determined on the basis of widely available financial information on the company's credit quality." The proposed rule would clarify that a plan must use third-party financial information to satisfy this criterion, rather than information generated by the company itself and available on its website.

4010 FILINGS

The proposed rules make a number of changes and clarifications to the 4010 filing requirements.

Identifying information for large controlled groups. Filers with more than 10 controlled-group members would satisfy the requirement to show the relationship of controlled-group members by submitting an organizational chart or other diagram. Filers with fewer controlled-group members would continue to describe in the e-filing portal each entity's relationship to the plan sponsor.

Actuarial assumptions for cash balance plans. A cash balance plan would determine its benefit liabilities by converting the account balance to an annuity using the interest crediting rate and annuity conversion rate for terminating cash balance plans, as specified in the regulations under Internal Revenue Code Section 411(b)(5)(B)(vi).

COPYRIGHT 2019 MERCER LLC. ALL RIGHTS RESERVED.

Controlled-group financial information. The proposal makes the following changes to the controlled-group financial information requirements:

- Filers providing consolidated controlled-group financial information would no longer have to break out each controlled-group member's revenues, operating income and net assets.
- When the parent at the top of a controlled group is a foreign entity, filers providing consolidated controlled-group financial information also must separately provide financial information — either on a consolidated basis or through individual financial statements or tax returns — for US controlled-group members.
- Filers must provide a specific web address (URL and title of the web page) if directing PBGC to required financial information publicly available on a website.

Filing waivers. Two filing waivers — the $15 million shortfall waiver and small-plan waiver (for controlled groups with fewer than 500 participants in all plans) — are available when a filing is triggered solely by a plan's failure of the 80% gateway test. The proposal would clarify these waivers and add a new one:

- The $15 million shortfall and small-plan waivers consider only plans in the controlled group on the last day of the information year. This is consistent with the 80% gateway test, which ignores plans that no longer exist or are no longer in the controlled group on the last day of information year. This clarification formalizes earlier PBGC informal guidance in the 2017 EA Blue Book, Q&A-17.
- When determining a plan's 4010 funding shortfall for the $15 million shortfall waiver, filers don't have to use at-risk assumptions to determine the funding target, unless the plan is at-risk for funding purposes.
- PBGC will waive reporting if a plan sponsor's late election to reduce its funding (credit) balance is the sole cause of the plan's failing the 80% gateway test.

STANDARD TERMINATIONS

ERISA requires the administrator of a plan undergoing a standard termination to submit within 30 days after the final distribution of assets a "post-distribution certification," informing PBGC that the plan's assets have been distributed to pay all plan benefits. This deadline can be difficult to meet due to the amount of information that needs to be collected. The proposed rule would allow plan administrators an additional 30 days to submit the certification (a completed Form 501 and attachments), as long as the administrator certifies to PBGC by the 30-day statutory deadline that that all assets have been distributed.

COMMENTS REQUESTED

Comments on the proposal are due by Aug. 26. Although comments are welcome on any aspect of the proposal, PBGC has specifically requested comments on the following issues:

- Whether and how PBGC should make available to foreign private issuers the proposed extension of the Form 10 filing deadline for a public company that has a liquidation event

COPYRIGHT 2019 MERCER LLC. ALL RIGHTS RESERVED.

- Whether the public company waiver — which waives reporting for certain events if a contributing sponsor is a public company and timely files a SEC Form 8-K disclosing the event — should be expanded to apply in situations where a parent company timely files a Form 8-K but is not a contributing sponsor to the plan

EFFECTIVE DATE

The proposal doesn't mention an effective date, but presumably the changes would take effect when the final rules are published in the Federal Register. PBGC has characterized some of the proposal's provisions simply as clarifications of existing rules, which suggests the agency believes those positions are already in effect. But some plan sponsors and practitioners might disagree. For example, the preamble says the change to the special rule for moving the participant count date is a clarification meant to shut down strategies that some sponsors may have used to achieve FRP savings. Sponsors considering such transactions before the proposal is finalized — including sponsors that have already undertaken such transactions but have yet to pay their 2019 premiums — should consult with counsel.

RELATED RESOURCES

- Proposed PBGC Rule: Miscellaneous Corrections, Clarifications and Improvements (Federal Register, July 27, 2019)

Note: Mercer is not engaged in the practice of law, accounting or medicine. Any commentary in this article does not constitute and is not a substitute for legal, tax or medical advice. Readers of this article should consult a legal, tax or medical expert for advice on those matters.

COPYRIGHT 2019 MERCER LLC. ALL RIGHTS RESERVED.