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Pension Benefit Guaranty Corporation's Early Warning Program

By Dorothy D. Parson McDermott[*]

Under the Early Warning Program, also referred to as the Risk Mitigation Program, the Pension Benefit Guaranty Corporation (PBGC) monitors sponsors of defined benefit plans and reviews corporate transactions that pose an increased risk of long-run loss to the pension insurance program. In-house financial analysts monitor more than 1,150 companies by reviewing company financial statements, government reports, actuarial valuations, and public announcements of major transactions. This analysis helps the agency evaluate the risk of future plan terminations and identify transactions that may hurt plans and their participants.

For monitoring purposes, the PBGC generally focuses on companies that are financially troubled or have a significantly underfunded pension plan. The PBGC reports that on average it internally identifies about 100 transactions or events each year that are of concern and prompt it to seek more information.

When the PBGC discovers transactions that pose a risk to pension plan solvency, the agency will negotiate with corporate representatives for plan protections, such as additional contributions or security. Settlements under the Early Warning Program vary, based on the specific circumstances of the transaction and financial solvency of the company.

PROGRAM FOCUS

The Early Warning Program, established in 2000 by Technical Update 00-3, focuses on business transactions that might pose an increased risk of long-run loss to a defined benefit plan. In determining long-run loss, the PBGC focuses on financially troubled companies and companies with pension plans that are underfunded on a current liability basis.[1]

The PBGC stated in 2013 that it was in the process of updating Technical Update 00-3, and that the screening criteria in that Technical Update were no longer applicable given the enactment of the Pension Protection Act of 2006.[2]

In determining if companies and their plans are in trouble, PBGC looks at employers with plans that:

- in the aggregate have $50 million or more in underfunding;[3] or

- 5,000 or more participants.[4]

However, other companies may also be monitored, depending upon the facts and circumstances. In 2013,

[*] Dorothy "Dottie" D. Parsons McDermott is a principal in the Indianapolis, Indiana, office of Jackson Lewis P.C. She concentrates her practice in the defense of civil rights and employment-related claims, as well as ERISA and non-ERISA employee benefits matters, including bad faith and breach of contract claims.

[1] PBGC's Early Warning Program, Technical Update 00-3, II.1 (July 24, 2000). See also PBGC Issues Technical Guidance On Operation of Early Warning Program, 27 Pens. & Ben. Rep. (BNA) 1,740 (July 25, 2000).

[2] Summary of Discussions between the Enrolled Actuaries Program Committee and Staff of the Pension Benefit Guaranty Corporation (Feb. 14, 2013) available at http://www.pbgc.gov/Documents/2013bluebook.pdf.

[3] The calculation of $50M or more in underfunding takes into account the aggregate underfunding of all plans maintained by the controlled group. The numbers for each plan are based on the most recent and best information available to PBGC. The underfunding may be taken directly from submitted filings (e.g., ERISA §4010, premium filings or Schedule SB of Form 5500). Alternatively, it may be an estimate prepared by PBGC actuaries in which available assets and liability data is adjusted to reflect underfunding on a termination basis. *Id.* at Question 22(c).

[4] The calculation of 5,000 or more participants is based on numbers reported for all plans maintained by the controlled group. The participant count is based on the most recent data available to PBGC and is derived from a variety of sources, including ERISA §4010 information, Form 5500 and PBGC premium filings and responses to PBGC inquiries to the plan sponsor. *Id.* at Question 22(d).

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there were approximately 1,000 employers being monitored in the Early Warning Program.[5]

The PBGC also said that it may monitor an employer without regard to its credit rating. However, the PBGC may take an employer's bond rating into account in determining whether a situation involves a risk to PBGC.[6]

BUSINESS TRANSACTIONS OF CONCERN TO THE PBGC

The PBGC is most concerned under the Early Warning Program with business transactions that substantially weaken a pension plan's financial support. Examples of such business transactions include:[7]

- breakup of a controlled group, including a subsidiary spin-off;
- transfer of significantly underfunded pension liabilities in connection with the sale of a business;
- leveraged buyouts;
- major divestitures by an employer that retains significantly underfunded pension liabilities;
- payment of extraordinary dividends; or
- substitution of secured debt for a significant amount of previously unsecured debt.

Screening Methods

The key to the Early Warning Program is identifying the companies that pose the greatest risk to the PBGC. The agency uses financial information services and news databases, and information obtained from a ''reportable event'' and other filings, to identify companies and transactions that qualify for the program.[8] The PBGC also gets information from the Department of Labor, the Internal Revenue Service, and the Securities and Exchange Commission.

Generally, plan sponsors could expect the PBGC to ask for further information on one of these business transactions if either of the following conditions apply:

- the company has a below investment-grade bond rating and sponsors a defined benefit pension plan whose current liability exceeds $25 million; or
- the company's defined benefit pension plan shows a current liability of more than $25 million and an unfunded liability of over $5 million.

A change in a plan sponsor's credit quality does not trigger an Early Warning Program review, though the PBGC generally includes credit quality as part of the analysis when a sponsor's transaction merits a review, according to the May 2017 questions and answers. The PBGC does not use information provided in the ERISA §4010 notice of underfunding to open an Early Warning Program review, and the filing of the ERISA §4010 notice is not a trigger for the Early Warning Program. The PBGC may use the financial data provided under the notice in its analysis so the plan sponsor need not provide it again. The PBGC sends a close-out letter to the plan sponsor when it has decided to close an Early Warning review.[9]

REPORTING REQUIREMENTS

ERISA §4010 reporting is an independent basis for PBGC contact under the Early Warning Program. and the PBGC's implementing regulations require controlled groups that maintain plans with significant funding problems to file annual reports with PBGC containing certain financial and actuarial information. PBGC uses this information to monitor underfunding of plans and the financial condition of the employers maintaining them.

Certain events that trigger the reporting requirement to the PBGC under ERISA §4043, include:

- active participant reduction,
- failure to make required funding payments,
- inability to pay benefits when due,
- distribution to a substantial owner,
- change in contributing sponsor or controlled group,
- liquidation of a contributing sponsor or controlled group member,
- extraordinary dividend or stock redemption,
- transfer of benefit liabilities,
- application for minimum funding waiver,
- loan default,
- bankruptcy insolvency or similar settlements, and,
- total underpayments, with interest, exceed $1,000,000.

Active participant reduction under ERISA §4043 (noted above) means as a result of a single cause

[5] *Id.* at Question 22(a).

[6] *Id.* at Question 22(b).

[7] Id . at III. See also PBGC Issues Technical Guidance On Operation of Early Warning Program, 27 Pens. & Ben. Rep. (BNA) 1,740 (July 25, 2000).

[8] *See* PBGC's Early Warning Program, PBGC Fact Sheet.

[9] Risk Mitigation & Early Warning Program (Dec. 2016); Technical Update 00-3; Risk Mitigation & Early Warning Questions and Answers (May 2017).

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(such as a reduction-in-force or reorganization) or through employee attrition, the number of active plan participants is reduced below 80% of the number at the beginning of the year or below 75% of the number at the beginning of the prior year. On September 25, 2017, the PBGC issued Technical Update 17-1 to clarify:

- when assessing the 80% threshold, the plan may include in the year-end active participant count participants who ceased to be active during the plan year due to a reported single-cause event;
- when assessing the 75% threshold, the plan may include in the year-end active participant counts participants who ceased to be active participants during the current or prior plan year because of a reported single-cause event.

To make a report for any of the above circumstances to the PBGC, it must be made on Form 10 within 30 days after the event occurs. In addition, for large cumulative funding underpayments over $1,000,000, reporting to the PBGC is required 10 days after the due date on Form 200.[10]

Most often, plan sponsors are required to notify PBGC within 30 days following an event on PBGC Form 10. Terminating plans are not excused from a timely notification of a reportable event unless the deadline for filing notice is on or after the date that (1) all of the plan's assets (other than excess assets) are distributed pursuant to a termination under 29 C.F.R. §4041, or (2) a trustee is appointed for the plan under ERISA §4042(c).

However, certain privately held companies must file a notice 30 days in advance of the event on PBGC Form 10-Advance. The advance reporting requirements primarily apply to the U.S. subsidiaries of foreign companies with aggregate plan underfunding of vested benefits of more than $50 million and an aggregate funded vested benefit percentage of less than 90%. All such reporting must be submitted electronically by email or through the ERISA §4043 module of the PBGC's new e-filing portal.[11]

The penalty for not reporting may be up to $2,194 per day for any required notice against each plan administrator and contributing sponsor required to provide notice. The PBGC assesses each case on an individual fact and circumstances basis considering, among other things, the importance and time-sensitivity of the required information, the extent of the omission, the willfulness of the failure to report, the length of delay, and the size of the plan. The PBGC typically increases penalties as the length of delay increases; reduces penalties for small plans; and limits total penalties based on plan size.

Generally, however, the PBGC assesses a penalty of $25 per day for the first 90 days of deficiency, and $50 per day thereafter. In addition, the agency often proportionality reduces the penalty based on the number of plan participants when there is less than 100 participants, subject to a floor of $5 per day. For instance, if there are 25 plan participants, the penalty would be $6.25 per day (25% of $25 per day) for the first 90 days, and $12.50 per day (25% of $50 per day) for 91 days and after. However, the PBGC had adjusted the penalty up for inflation, from $1,000 per day to $2,194 per day (based on a multiplier of 1.02522), so it is possible these figures may likewise increase.[12]

On September 11, 2015, the PBGC issued the ''2015 Final Rule,'' which revised procedures governing when administrators and sponsors of single employer defined benefit pension plans are required to report events. The goal of the 2015 Rule was to make reporting requirements easier even when notice was not necessary so the PBGC could intervene earlier and help sponsors maintain a plan and/or preserve participant's benefits. Through studies, the PBGC anticipated that the 2015 Final Rule would exempt about 94% of plans and sponsors from many reporting requirements.

In certain circumstances, a commercial measures waiver is available when a company that is a contributing sponsor of a plan has adequate capacity to meet its obligations, referred to as a financial soundness safe harbor. This safe harbor is met if the probability of default on the company's financial obligations is no more than 4% over the next 5 years; or, 0.4% over the next year, based on financial information regarding the company's credit quality.[13]

POSSIBLE ADDITIONAL UPDATES IN 2019-2020

On June 27, 2019, the PBGC issued a proposed new rule that could affect reportable events under 29 C.F.R. §4043.[14] The proposed rule comment period that ended on August 26, 2019, and five comments

[10] Additional information regarding the reportable events are available at the Enrolled Actuaries Program Committee and PBGC 2017 Bluebook, Questions 9-14, available at https://www.pbgc.gov/sites/default/files/legacy/docs/2017bluebook.pdf#page=12 .

[11] Available at https://efilingportal.pbgc.gov/site.

[12] 83 Fed. Reg. 248 (Dec. 28, 2018); 60 Fed. Reg. 36,837 (July 18, 1995); 29 C.F.R. Part 4071; PBGC's Statement of Policy on Assessment of Penalties for Failure to Provide Required Information; https://www.pbgc.gov/prac/reporting-and-disclosure/reportable-events-faqs.

[13] 80 Fed. Reg. 176 (Sept. 11, 2015).

[14] See 84 Fed. Reg. 20,666.

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were received. If approved, the new rule will clarify when a liquidation event occurs and provide examples for active participant reduction, liquidation, and change in controlled group events. Under the June 27, 2019, proposed rule, this provision would be amended to clarify that financial information may be obtained from a third party only, not from the company itself.

In April 2013, PBGC re-proposed rules to exempt most companies from reporting events if they qualify for a financial soundness safe harbor as established through a credit report. The proposal would expand waivers for small firms, modify some waivers, and eliminate others.[15]

INFORMATION REQUESTS

The PBGC generally requests during an initial inquiry of a business transaction information about the effect of the transaction on the company's defined benefit plan. This can include information on whether the plan will stay with the plan sponsor, move to a new plan sponsor, or be split between the current sponsor and a new sponsor. The PBGC also might ask for recent actuarial information from the plans, including the most recent Form 5500 and actuarial valuation reports.[16]

During follow-up inquiries, the PBGC might request financial information on the plan sponsor and its controlled group. Additional information that the PBGC can request in a follow-up inquiry includes:[17]

- the latest market value of each plan's assets;
- any contributions made that are not included in the market value of assets;
- information about any events that have had a material effect on the plans since the last actuarial valuation; and
- where a plan is moving to a new sponsor or being split between the current and a new sponsor, information about the number of active, deferred vested, and retired participants affected by the transaction.

INCORRECT INFORMATION

Companies that are contacted by the PBGC under the Early Warning Program receive a letter that includes the pension plan data that triggered the contact letter, as well as a request for additional information about the transaction. The pension plan data is taken from the most recent Form 5500, Schedule B. If the data in the contact letter is incorrect or there is a more recently filed Form 5500, Schedule B, the up-to-date or corrected data should be sent to the PBGC.[18]

Outcome of Information Review —

The PBGC outlines four scenarios following review of a transaction under the Early Warning Program:

1. PBGC completes internal review and finds there is no risk to the insurance program or plan participants, and the issue is closed without contacting the plan sponsor. Reviews handled in this manner constitute the bulk of the Early Warning Program activity, or an estimated two thirds of reviewed transactions.

2. If after a review of a transaction the PBGC identifies potential increased risk, then it will contact the plan sponsor to learn more and request information about the sponsor and pension plan(s). Following discussions with them and review of information, if the PBGC finds the transition does not present an increased risk of loss to the insurance program or plan participants, then the review is closed. A closing letter is sent advising the matter is formally closed. The closing letter generally is sent at the time the PBGC makes its decision, but not later than 30 business days from the date the requested information is received.

3. If the issue is still open, the PBGC and plan sponsor begin negotiating protections for the pensions and the sponsor decides to make additional pension contributions outside of a settlement with the PBGC.

4. The sponsor negotiates with the PBGC, and the two enter into an Early Warning Program agreement to protect the sponsor's pension plans.

After reviewing the requested information, the PBGC will determine that no action is necessary or that the transaction might create an increased risk of loss to the pension plan.

Where the PBGC determines that no further action is necessary, the agency will send a closing letter advising that the inquiry is formally closed.[19] The closing letter generally is sent at the time the PBGC makes its decision, but not later than 30 business days from the date the requested information is received.

If the PBGC determines that the transaction could result in a loss, the agency will negotiate with the company for pension protections.

[15] PBGC Reg. 29 C.F.R. §4001.1, §4043.1, §4065.1

[16] PBGC's Early Warning Program, Technical Update 00-3, IV.4 (July 24, 2000).

[17] *Id.* at IV.5.

[18] *Id.* at II.3.

[19] *Id.* at IV.6; https://www.pbgc.gov/prac/risk-migration/faq.

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EARLY WARNING PROGRAM SETTLEMENTS

Pension Protections

When the PBGC determines that a transaction could result in a significant increase in the risk of loss, the agency negotiates with the applicable company to obtain protections for the pension insurance program. The PBGC can even terminate the plan if the agency feels it is necessary. The agency tailors settlements under the program to ensure that they are ''appropriate to the particular business transaction and economically feasible for the company.''[20]

Protections that have been negotiated under the Early Warning Program include:[21]

- additional cash contributions to the plan;
- letters of credit to secure promises to make future pension contributions or secure underfunded pension plan liabilities;
- pledges of specific company assets to secure unfunded pension plan liability; and
- in controlled group breakup transactions, guarantees by financially stronger members that are leaving the controlled group to assume the pension plan or pay for termination liability if the plan sponsor cannot support the plan following the transaction.[22]

Sample Settlements

The PBGC has reached numerous settlements with companies under the Early Warning Program. Indeed, over the past five years, the PBGC reports that of the 100 initial transactions or events resulting in contact with plan sponsors, it entered into an average of 5 settlements / modifications each year.

- Motorola Solutions. Motorola Solutions, formerly named Motorola, agreed in 2011 to contribute an additional $100 million to the Motorola Pension Plan during the subsequent five years. A deal on the $100 million payment was reached as the company was considering a spin-off of its Motorola Mobility business and a sale of some assets of its Networks business. PBGC said the remaining enterprise, known as Motorola Solutions, would continue to sponsor the pension plan, which had 87,000 participants. PBGC said the agency learned of Motorola's business plans through the agency's Early Warning Program.[23]
- Crown Central Petroleum Corp. Crown Central Petroleum Corp. agreed in 2005 that it will contribute $45 million to its underfunded pension plan, covering more than 3,000 workers and retirees. Under the terms of the settlement, closely held Rosemore Inc. of Baltimore will assume direct responsibility for the plan of its subsidiary Crown, which is divesting its operations. PBGC determined that immediate sponsorship by Rosemore was essential because Crown would lack the resources to administer and finance the plan after it sells substantially all of its operations. As security for payment by Crown of the additional pension contributions, PBGC will hold liens on certain of the company's assets.[24]
- PricewaterhouseCoopers. An agreement reached in 2002 with PricewaterhouseCoopers increased overall pension funding by $264 million in the company's pension plan, covering nearly 47,000 workers and retirees. Under the agreement, which resulted from talks entered after PBGC learned of the proposed sale of PwC's consulting business to IBM, PwC would transfer $200 million to its defined benefit plan within a week of the sale's closing, and would contribute an additional $64 million by March 15, 2003. PwC also agreed to maintain the plan's existing credit balance and make annual plan contributions in amounts greater than required by law.[25]

[20] *Id.* at V.

[21] *Id.*

[22] *Id.*; https://www.pbgc.gov/prac/risk-migration/faq.

[23] Motorola Agrees to Transfer $100 Million to Plan, 38 Pens. & Ben. Rep. (BNA) 50 (Jan. 11, 2011).

[24] *Agency Reaches Agreement With Firm To Strengthen Pensions at its Subsidiary*, 32 Pens. & Ben. Rep. (BNA) 428 (Feb. 22, 2005).

[25] *PricewaterhouseCoopers Agrees To Contribute $264 Million to Pension Plan*, 29 Pens. & Ben. Rep. (BNA) 2,666 (Oct. 8, 2002).

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