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PBGC Issues Proposed Regulations on Phase-In of Guarantee for Shut-Down Benefits

The PBGC has issued proposed regulations interpreting the PPA provision that changed the rule for phasing-in shutdown and other unpredictable contingent event benefits for purposes of the PBGC's guarantees. Under PPA, effective for events that occur after July 26, 2005, the earliest date the phase-in period can begin is the date the event occurs. The proposed regulations provide examples of how the rule applies in different fact situations.

Background

When the Pension Benefit Guaranty Corporation (PBGC) becomes the trustee of a terminated, underfunded defined benefit plan, the PBGC assumes responsibility for paying participants (and beneficiaries) their retirement benefits under the plan. Under the Employee Retirement Income Security Act (ERISA), the amount the PBGC "guarantees" to pay a participant depends on several factors including the plan's benefit provisions and the maximum guaranteed benefit for the year of plan termination for a person of the participant's age. The PBGC pays some participants more than the guarantee based on a complex formula allocating plan assets.

Not all benefits are guaranteed. Benefits earned after the plan's termination date are not guaranteed under any circumstances. In addition, benefit increases resulting from plan amendments adopted or effective (whichever is later) in the five years prior to the plan's termination date are only partially guaranteed. The guarantee of these amendments is phased in at 20% after the first year, with 20% additional phase in after each of the following four years. Prior to the Pension Protection Act of 2006 (PPA), PBGC treated a provision providing for unpredictable contingent event benefits (UCEBs), which are benefits resulting from the occurrence of an unpredictable contingent event (UCE), as being adopted when the provision was first included in the plan (as opposed to when the event occurred). Thus, if the UCEB provision was included in the original plan, and the date of plan termination was more than five years later, the PBGC guarantee would cover the UCEB even if the UCE occurred the day before the plan termination.

A UCEB, which is defined more specifically below, is essentially an additional benefit that the plan pays only if a UCE occurs (rather than because of age or service). For example, a shutdown, which is one of the most common forms of UCE, frequently allows a participant to retire early without a reduction in benefits (the UCEB is the reduction that is not imposed). The triggering "shutdown" could be the closing of a plant or a line of business, or a layoff.

BUCK COMMENT. *Shutdown benefit provisions are frequently found in union pension plans in specific industries such as steel, rubber, and auto. Because plant shutdowns are frequently tied to employer financial distress and plan termination, shutdown benefits have been a major cost to the PBGC.*

PPA provides that in the case of a UCEB, for purposes of the phase-in of the PBGC guarantee, the amendment of a plan to include the UCEB provision shall be considered to occur at the time the UCE occurs. Thus, in the case of a plant shutdown benefit, the plan is considered to have adopted the amendment at the time of the plant shutdown, and the five-year phase-in starts at that point.

BUCK COMMENT. *Historically, the PBGC rushed to court in many cases to ask the court to terminate a plan to avoid long run loss to the PBGC. The PBGC needed the plan's termination date to be before the plant shutdown to avoid paying the shutdown benefits. With the PPA change, whether the PBGC terminates the plan shortly before or within a year after the plant shutdown, the PBGC avoids guaranteeing the shutdown benefits.*

The Proposed Regulations

UCE and UCEB Definitions

The [PBGC proposed regulations](#) provide that, for purposes of the PBGC guarantee, the terms UCE and UCEB have the same meaning as they do in the benefit restriction regulations under Section 436 of the Internal Revenue Code (Code). A UCEB is any benefit or benefit increase that would not be payable but for the occurrence of a UCE. The proposed regulations take the position that a benefit that is a UCEB does not stop being a UCEB because the UCE occurs or becomes reasonably predictable.

BUCK COMMENT. *In the preamble to the proposed regulations, the PBGC argues that its position on UCEs that occur or become predictable follows from the plain language of Code Section 436, which defines a UCE solely based on the triggering event.*

A UCE includes a plant shutdown (full or partial) or a similar event such as a full or partial closing or another type of reduction, or any event other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or occurrence of death or disability. The proposed regulations include, as examples of UCEBs, unreduced early retirement benefits and other early retirement subsidies to the extent the benefit would not be payable without a UCE. The proposed regulations include, as examples of UCEs, full and partial closings of plants or other facilities and permanent workforce reductions, such as permanent layoffs (including layoffs in which an idle worker earns credits (known as "creep-type" layoffs) and layoffs that become permanent on occurrence of an additional event.

BUCK COMMENT. *Historically, some persons at the PBGC have argued that early retirement windows should be treated in certain fact patterns as UCEs. The proposed regulations do not appear to take that position.*

PBGC Determination of Event and Time

The proposed regulations provide that the phase-in of the PBGC guarantee of a UCEB occurs at the latest of three dates:

- The adoption date of the plan provision that provides for the UCEB;
- The effective date of the UCEB; or
- The date the UCE occurs.

BUCK COMMENT. *The PBGC added the adoption date of the plan provision that provides for the UCEB to address the unlikely situation of a retroactive adoption of a plan provision providing UCEBs.*

The proposed regulations specifically provide that it is the PBGC that determines when an event is a UCE and when a UCE occurs for purposes of the guarantee. The PBGC will make these determinations based on the plan provisions and all the facts and circumstances. The proposed regulations treat how the benefit is characterized by the employer or another party as relevant but not determinative. For purposes of determining when a UCE occurred, the following facts may be relevant (but they are not determinative):

- The nature and level of activity at a facility that is closing;
- The permanence of the event; and
- The date of the event as conceived, planned, announced, or agreed to by the employer.

BUCK COMMENT. *Under the new phase-in rules, It is reasonable to expect that the PBGC will want a questionable event to be a UCE and for the event to be treated as occurring as late as possible. This may also be in the employer's interest because it lowers the employer's liability, but such determinations will mean workers have a lower PBGC guaranteed pension. If participant groups challenge the PBGC's interpretation in court, it is unclear how much of an advantage the PBGC will have by including in the proposed regulations the provisions saying it has the right to determine what is a UCEB and when the UCE occurred.*

The date the UCE occurs is a participant-by-participant determination or, depending on the facts, a facility-wide or company-wide determination. Participants in the same plant can have different relevant dates depending on when they qualify for the benefit. Some UCEBs require more than one UCE. For purposes of the guarantee phase in, it is the second UCE that is relevant.

Examples

Much of the proposed regulations consist of examples of how the PBGC would apply the rule in specific situations.

Situation 1. Shutdowns that Occur Later than the Announced Date. The actual date of the shutdown would govern, not the announced date.

Situation 2. Sequential Permanent Layoffs. Each group of participants or each participant would have a shutdown date tied to when that group or individual had a permanent layoff.

Situation 3. Skeleton Shutdown Crews. The continuation of a minimal skeleton crew would not prevent a facility closing from being a UCE; however, with respect to the members of the skeleton crew, their UCEs would occur when each was eventually laid off. If the individual's UCE was after the plan's termination date, the PBGC would not guarantee that person's UCEB at all.

Situation 4. Creep-Type Layoff and Bankruptcy. In the case of a plan termination occurring while a company is in bankruptcy, the bankruptcy date will retroactively be treated as the plan's termination date. If a participant had been laid off before the bankruptcy but the layoff was not permanent until after the bankruptcy, the PBGC would not guarantee the benefit. For those permanently laid off before the bankruptcy, the bankruptcy date would be the plan termination date for purposes of counting the number of years the UCE occurred prior to the plan termination.

Situation 5. Creep-Type Layoff and Later Employer Declaration that Return Unlikely. The guarantee of the UCEB would be based on the date of the announcement that return is unlikely.

Situation 6. Age Requirement that Can Be Met after Shutdown. In this case, the PBGC would treat the date of the shutdown as the relevant date, not the date the age requirement was satisfied (even if the age requirement was satisfied after the plan termination date). This is because the second event, attainment of an age, is not a UCE.

Situation 7. Retroactive UCEB. In the case of a UCEB that is retroactively added to the plan after the UCE occurred, the date the retroactive provision was added to the plan is the relevant date.

Situation 8. Removal of Benefit Restriction. Code Section 436 provides that a plan may not pay a UCEB if the UCE occurs at the time a plan's funding percentage (i.e., the adjusted funding target attainment percentage or AFTAP) is less than 60% or the cost of the UCEB would bring the AFTAP below 60%. However, a sponsor may make a special 436 contribution equal to the cost of the shutdown benefit or the amount necessary to bring the AFTAP back to 60% to retroactively eliminate the benefit restriction. The PBGC treats the UCE as having occurred when the UCE actually occurred and not when the sponsor made the 436 contribution (i.e., in this case, the PBGC ignores the restriction).

Conclusion

The PBGC generally wants the UCE to be treated as occurring as late as possible. If the UCE occurs after the date of plan termination, the PBGC does not guarantee the UCEB at all. If the UCE occurs prior to the date of plan termination, the PBGC wants to minimize the phase in of the guarantee, which means having the shortest period between the UCE and the date of the plan termination.

The regulations provide useful clarifications but few surprises. It is to be seen whether the PBGC's insistence in the proposed regulations that it is the one that determines whether a benefit is a UCEB and when the UCE occurs becomes a subject of much litigation.

Until the proposed regulations are adopted in final form, they are not effective. However, they are strong indicators of the positions that the PBGC intends to take under the Title IV statutory provision, which is already effective.

Buck's consultants are available to help you interpret the proposed regulations and apply them to your situations. We are also available to assist you with any comments you would like to provide to the PBGC on the proposed regulations. Comments are due by May 10, 2011.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.