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PBGC Issues Final Regulations Governing Termination Date of Pension Plans Ending During Bankruptcy

The PBGC issued final regulations implementing PPA's provisions setting the termination date of a pension plan that is terminated during a bankruptcy proceeding as the bankruptcy filing date for certain purposes. The regulations impact PBGC-paid benefits but not employer liability. The final regulations essentially adopt the proposed regulations.

Background

When a defined benefit pension plan terminates without sufficient assets to pay all benefits, the Pension Benefit Guaranty Corporation (PBGC) becomes the trustee of the plan and pays benefits to the participants. Prior to enactment of the Pension Protection Act of 2006 (PPA), the PBGC used one date – the plan's actual termination date – for all purposes, including to determine the plan's assets and liabilities, the PBGC's guaranteed benefit amounts, and the employer's further liability. The filing of a bankruptcy petition did not directly affect the plan's termination date.

Section 404 of PPA amended the Employee Retirement Income Security Act (ERISA) to treat the bankruptcy date rather than the plan's actual termination date as the termination date but only for the following two purposes:

- Calculating the PBGC's guaranteed benefits under ERISA Section 4022; and
- Determining priority category 3 (PC-3) coverage and benefits under ERISA Section 4044.

PC-3 can result in the PBGC paying benefits in excess of guaranteed benefits to participants that were in pay status or could have been in pay status (if the participant had retired) at last three years before the termination date. For purposes of PC-3, the applicable participant's benefit is the lowest annuity benefit payable under the plan provisions at any time during the five-year period ending on the termination date. On July 1, 2008, the PBGC issued [proposed regulations](#).

Final Regulations

The PBGC's [final regulations](#) are "nearly the same" as the proposed regulations, "with only a few minor differences." The regulations have no impact on the benefits accrued under the plan. They only affect the part of the benefits paid by the PBGC.

Under the final regulations, as under the proposed regulations, the bankruptcy date is treated as the termination date for purposes of determining the following:

- The participant's service and compensation;
- The relevant maximum guaranteeable benefit;
- The relevant date for measuring the phase-in of benefit guarantees;
- The accrued-at-normal benefit (i.e., what benefits are non-guaranteed supplements);
- The relevant date for determining whether participants have satisfied the conditions for an early retirement subsidy or have become disabled; and
- The relevant year for the start of the look-back period for both the three year and five year rules.

In a minor change from the proposed regulations, the final regulations expand the five-year look-back period under PC-3 to address situations where benefits decrease between the bankruptcy date and the plan's actual termination date. The final regulations provide that the PBGC will use the lowest annuity benefit in a special expanded period – the period between the plan's actual termination date and the bankruptcy date plus the five-year period before the bankruptcy date. In another minor change, the regulations provide that if a participant dies between the bankruptcy date and the plan's actual termination date, the PBGC will value the benefit being paid on the plan's actual termination date but will determine the guarantee level as of the bankruptcy date.

BUCK COMMENT. *The PBGC rules governing guarantees and allocations are quite complex. The PBGC made these changes to provide simplified and more consistent administration.*

In some cases, a participant might begin receiving a benefit that includes an early retirement subsidy based on satisfying the conditions for the subsidy after the bankruptcy date. If the plan then terminates, the bankruptcy date is treated as the termination date, and the PBGC guarantee no longer covers the early retirement subsidy. In that case, the regulations provide that the PBGC will continue to pay the participant a benefit, but the PBGC will reduce the benefit to eliminate the amount of the subsidy.

BUCK COMMENT. *The PBGC rejected a request to allow these participants the ability to stop all payments until a future date.*

As under the proposed regulations, the plan's actual termination date remains relevant for all valuation purposes. This includes valuing the plan's assets and liabilities on the termination date and determining the value of PC-3 benefits. If a plan has more than one contributing sponsor and not all of the sponsors file for bankruptcy or file on the same date, the PBGC will determine the applicable bankruptcy date based on all the facts and circumstances. Finally, the regulations make clear how any PBGC recoveries from the employer will be split between the PBGC and plan participants.

BUCK COMMENT. *A plan sponsor's liability on the termination of an underfunded pension plan is only to the PBGC and is measured by the amount of unfunded benefits (the difference between the plan's assets and liabilities) regardless of the amount guaranteed by the PBGC. As a result, neither the statute nor the regulations affect employer liability.*

Conclusion

The statute and the regulations impact the benefits that the PBGC will pay participants. The statutory change and regulations have minimal direct effect on employers. However, older workers face the possibility of lower benefits. This has been of great concern to their employee representatives and, thus, in some cases to employers who reorganize in bankruptcy.

Buck's consultants are available to help you analyze the impact of the regulations.

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.