

# **4062(e) Rules Changes & PBG**C** Enforcement**

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# PBGC Downsizing Liability: A Brief History

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- September 2, 1974
  - Liability trigger:
    - Employer “ceases operations” at “facility in any location,” and
    - Resulting >20% reduction in active headcount in any one PBGC-covered plan
  - If liability triggered:
    - Treat employer as if it were substantial employer who withdrew from multiple-employer plan
    - Liability amount = plan termination liability x employer’s percentage share of all required plan contributions for last five years
    - Satisfy liability through escrow or up-to-150% bond in case of underfunded plan termination within 5 years

# PBGC Downsizing Liability: A Brief History (Cont.)

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- 1974 to 2006:
  - Section 4062(e) largely dormant
  - Statutory formula, per PBGC, was “impracticable”
- 2006:
  - PBGC adopts *regulatory* liability formula
  - Liability = plan termination liability x plan’s active headcount reduction percentage
  - Sets stage for aggressive PBGC enforcement (generally through settlements calling for excess contributions)
- 2006 to 2010 (and beyond):
  - Pursuit of 4062(e) liability becomes centerpiece of PBGC enforcement program
  - Employers increasingly object to PBGC’s expansive (and changing) interpretations and aggressive enforcement

# PBGC Downsizing Liability: A Brief History (Cont.)

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- 2010:
  - PBGC issues proposed rule under which 4062(e) liability could be triggered where (e.g.):
    - Going-concern asset sale with operations/employment discontinuing with seller but continuing with buyer
    - Cessation of only one of multiple operations at facility with all other operations continuing at full strength
    - Transfer of operation(s) to other facility with no overall reduction in number of employees or level of operations
  - Public comments strongly object to these and other aspects of proposed rule

# PBGC Downsizing Liability: A Brief History (Cont.)

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- 2012: PBGC announces 4062(e) Enforcement Pilot Program
  - Forbearance for small plans (100-participant threshold)
  - Forbearance where employer is “financially sound” (but only for so long as employer remains financially sound)
- 2014: Major changes!
  - July: PBGC enforcement moratorium until yearend!
  - December: 4062(e) amended as part of FY 2015 omnibus appropriations bill, signed by President on 12/16/14!

# New Law Liability Trigger

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- Liability trigger
  - Basic liability trigger test:
    - *Permanent* cessation of operations at facility in any location, and
    - Cessation results in “workforce reduction” with more than 15% of all “eligible employees” separated from employment *at facility* “by reason of” cessation
  - “Eligible employee” means any employee of the employer who is eligible to participate in any employee pension benefit plan established and maintained by employer
    - Employee pension benefit plan: DB or DC plan
    - Eligible to participate: includes employee eligible to contribute to 401(k) plan who does not contribute

# New Law Liability Trigger (Cont.)

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- Liability trigger (cont.)
  - Note that “employer” per Title IV means all controlled group members treated together as single “employer”
  - Use of larger employment base can:
    - Help (significantly larger denominator in most cases)
    - Hurt (potentially larger numerator in some cases)
  - Watch out for potential effect on more controlled group plans!
    - Event occurs with respect to *any* single-employer plan established and maintained by employer covering participants at the facility (unless exemption applies)
    - Could trigger liability for plan with small (e.g., 5%) reduction in its active headcount

# New Law Liability Trigger

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- Liability trigger (cont.)
  - Special rules apply for:
    - *Excluding* certain eligible employees from numerator
    - *Including* certain eligible employees in numerator based on three-year lookback
  - Asset and stock sales (and other transfers of operations to different employer) may trigger liability (but subject to rules governing exclusion of certain eligible employees)

# New Law Liability Trigger (Cont.)

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- Interpretive issues
  - Definition of “facility in any location”
    - Two buildings across street, across town, across country?
    - Broader definition can help or hurt
    - Narrower definition can help or hurt
  - Whether/when “cessation” occurs
    - How complete?
    - One operation vs. all operations?
    - Date of voluntary cessation that occurs over period of time?
    - Date of involuntary cessation where employer decision not to resume operations is made well past triggering event?

# New Law Liability Trigger (Cont.)

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- Interpretive issues (cont.)
  - Whether/when employment status ends
    - What if employee was laid off with recall rights?
    - What if employee is on short-term or long-term disability?
    - Excluding employees from denominator can help or hurt
      - May help if otherwise *would* have been in numerator
      - May hurt if otherwise would *not* have been in numerator
  - Whether separation is based on cessation of operations
    - What if employee quits or retires?
    - What about involuntary separation where employer has reason *other than* (or in addition to) cessation?
    - How is normal attrition reflected?

# New Law Liability Trigger (Cont.)

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- Interpretive issues (cont.)
  - What does employment “at” the facility mean?
    - Employees working “at” multiple facilities?
    - Employees working primarily “on the road” but sometimes also “at” the facility?
    - Employees working from remote location (e.g., home) but coordinating with employees “at” the facility?

# New Law Liability Trigger (Cont.)

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- Exclusion of eligible employees
  - Special rules allow exclusion of certain eligible employees from numerator in specified situations
  - Relocation of workforce—exclude employee who is separated from employment at facility if:
    - Within reasonable time, he/she is replaced by employer at same or other facility of employer,
    - That facility is located in U.S., and
    - Replacement employee is citizen or resident of U.S.

# New Law Liability Trigger (Cont.)

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- Exclusion of eligible employees (cont.)
  - Transfer of operations where eligible employee is separated from employment with transferor employer at facility—exclude if:
    - He/she is replaced by transferee employer within reasonable time,
    - Replacement employee is citizen or resident of U.S., and
    - Where eligible employee is participant in transferor employer's single-employer plan, transferee assumes plan assets/liabilities for him/her

# New Law Liability Trigger (Cont.)

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- Exclusion of eligible employees (cont.)
  - Transfer of operations where eligible employee continues to be employed at facility by transferee employer—exclude if:
    - He/she is not participant in single-employer plan maintained by transferor employer, or
    - Transferee employer assumes plan assets/liabilities for him/her
  - Note that transfer of operations provisions apply in various situations
    - Asset sales
    - Stock sales
    - “Other” situations (e.g., transfer of government contract to new contractor at same facility)

# New Law Liability Trigger (Cont.)

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- Exclusion of eligible employees (cont.)
  - Interpretive issues
    - How similar must duties, responsibilities, compensation, etc., be to treat someone as “replacement” employee?
    - What constitutes a “reasonable period of time”?
  - Note that transferor employer must make determinations based on facts within control of transferee employer

# New Law Liability Trigger (Cont.)

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- Inclusion of eligible employees (three-year lookback)
  - Must take into account separation of eligible employee (unless not taken into account per exclusion rules) if:
    - Separation is “related to” the cessation, and
    - Separation occurred during three-year period preceding cessation
  - How does “related to” standard compare to “by reason of” standard for basic 15% threshold test?
  - Under what circumstances can “related to” test be met where separation precedes cessation decision?
    - Voluntary separations arguably in anticipation of cessation?
    - Significant layoffs when operations are expected to be reduced but are not expected to cease, yet operations later cease?

# New Law Liability Trigger (Cont.)

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- “As of” date for denominator
  - Denominator of liability trigger is determined immediately before earlier of:
    - Date of employer decision to cease operations
    - Date of first separation under three-year lookback
  - What is cessation decision date?
    - Decision by management vs. decision/approval by board of directors?
    - “Decision” that does not ripen into “final” decision until public announcement made or concrete implementation step taken?
    - Cessation based on loss of contract followed by ongoing but ultimately unsuccessful efforts to find new contract?
  - Effect of three-year lookback on numerator (increase) may be dwarfed by effect on denominator (increase or decrease)

# New Law Liability Exemption: Small Plans

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- Statutory exemption with respect to plan with <100 participants (on aggregated controlled group basis) as of valuation date for plan year preceding cessation plan year
- Aggregation rule may result in *no* controlled group plan qualifying for exemption even if *each* of multiple controlled group plans has <100 participants on stand-alone basis
- If statutory small plan exemption does not apply, consider whether small plan relief applies under PBGC's 4062(e) Enforcement Pilot Program
  - Different "as of" date
  - Different rules for counting participants (in particular, controlled group aggregation rule does not apply)

# New Law Liability Exemption: 90% Funded Plans

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- Statutory exemption with respect to plan that was at least 90% funded on variable-rate premium basis as of valuation date for plan year preceding cessation plan year
  - Calculation takes full assets (not just assets reduced by prefunding balance) into account
  - Making “excess” contribution to meet 90% level reduces VRP and may result in ability to use excess to offset following plan year’s minimum required contribution
- Potentially strong incentive to keep all plans funded at all times at/above 90% VRP level (4062(e) insurance policy)!

# Reporting of 4062(e) Event

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- Section 4063(a) notice to PBGC due within 60 days
  - New law does not amend Section 4063(a)
  - But new law impacts whether 4062(e) event occurs (e.g., through 15-percent threshold test, new exemptions)
- Whether or not 4063(a) notice requirement is triggered, 30-day reportable event notice may be required for (e.g.):
  - Active participant reduction reportable event
  - Change in contributing sponsor or controlled group
  - Liquidation
- Check reportable event waivers and extensions (some of which are tied to “cessation of operations” issues)

# New Law Liability Option

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- Employer can elect alternative method to satisfy liability:
  - Total liability amount = plan's unfunded vested benefits (VRP basis) times plan-specific headcount reduction percentage
  - 1/7 of amount paid to plan for each of 7 plan years (in addition to minimum required contribution), starting with cessation plan year
  - Payments cannot be used to create prefunding balance
  - Annual cap may limit annual payment
  - No payment required for (or after) 1<sup>st</sup> plan year for which plan is at least 90% funded on PBGC VRP basis

# New Law Liability Option (Cont.)

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- Liability amount—determination of UVB
  - Tied to variable-rate premium rules for plan year preceding cessation plan year
    - Determined as of valuation date for that preceding plan year (possible exception for small plan using UVB “lookback” rule)
    - Count full assets (not just assets reduced by prefunding balance)
    - Include contributions made after valuation date if:
      - Designated under funding rules as being for preceding plan year, and
      - Received by plan by premium filing date

# New Law Liability Option (Cont.)

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- Liability amount—determination of UVB (cont.)
  - Consider making “excess” contribution to reduce UVB even if 90% funded level for exemption is out of reach
  - UVB will usually be much less than “unfunded benefit liabilities” under regulatory liability formula, but could also be greater than UBL (check with actuary!)
- Liability amount—determination of plan-specific “reduction fraction”
  - “Reduction fraction” is essentially plan portion of “workforce reduction” used in 15% liability trigger test
  - Same “exclusion of eligible employees” rules apply
  - Same “3-year lookback” rules apply

# New Law Liability Option (Cont.)

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- Annual cap may limit 4062(e)(4) payment
  - Cap equals excess of:
    - 25% of VRP underfunding for prior plan year, over
    - Minimum required contribution for current plan year
  - Cap may significantly reduce annual 4062(e)(4) payment amount (e.g., to zero if minimum required contribution for current plan year at least equals 25% of VRP underfunding for prior plan year)

# New Law Liability Option (Cont.)

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- Cessation of 4062(e)(4) payment obligation
  - Required payments cease beginning with first plan year for which 90-percent funded level is reached (VRP basis)
  - Dropping below 90-percent level thereafter does not reinstate payment requirement
  - Example: 90-percent funded level reached for cessation plan year and therefore zero of seven payments required
- Time for electing alternative liability method
  - Election is due no later than 30 days after earlier of:
    - Date employer notifies PBGC of 4062(e) event, or
    - Date PBGC determines 4062(e) event has occurred

# New Law Liability Option (Cont.)

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- Time for electing alternative liability method (cont.)
  - Per legislative history:
    - Precautionary filing by employer (e.g., to avoid penalties) does not trigger 30-day period for electing
    - PBGC determination must be “final administrative determination”
    - Employer may make “conditional” election (which would become inapplicable to extent liability is later determined not to have been triggered or to be lower)
- Time for making alternative liability payments
  - Payments are required for plan year in which cessation occurs and for each of next six plan years

# New Law Liability Option (Cont.)

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- Time for making alternative liability payments (cont.)
  - Payments are due on earlier of:
    - Due date for minimum required contribution for the plan year (e.g., 9/15/16 for 2015 calendar plan year), or
    - For the first contribution, one year after date on which employer notifies PBGC of 4062(e) event or on which PBGC determines 4062(e) event has occurred (with later contributions due annually thereafter)
  - Per legislative history:
    - In all cases, employer will have at least one year's advance notice of need to make first payment
    - One-year period does not begin until PBGC makes *final* administrative determination

# New Law Liability Option (Cont.)

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- Alternative liability method will usually be right choice
  - Liability under alternative method
    - Usually lower than under PBGC regulatory formula
    - Subject to annual cap
    - Ceases when 90-percent funded level is reached
  - Even if liability is higher than under PBGC regulatory liability formula, manner of satisfying liability under alternative method may be more favorable than under
    - Section 4063 (escrow or bond), or
    - PBGC settlement (negotiated excess contribution schedule, security, etc.)

# New Law Transition and Related Rules

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- For pending cases (where cessation or other event occurred before 12/16/14 enactment date):
  - PBGC may not take enforcement/other action under 4062(e), or in connection with settlement of 4062(e) liability, if inconsistent with new rules (except if settlement in place before 6/1/14)
  - If no pre-enactment settlement and PBGC pursues case, employer can elect alternative liability option as if cessation occurred on 12/16/14
- PBGC may not initiate new enforcement action if inconsistent with its enforcement policy as in effect on 6/1/14

# Questions?

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For additional information on the new law, see *Section 4062(e) Liability Reformed: A Summary and Analysis of the New Law*, available at [www.keightleyashner.com/publications/022715-BNA.pdf](http://www.keightleyashner.com/publications/022715-BNA.pdf).