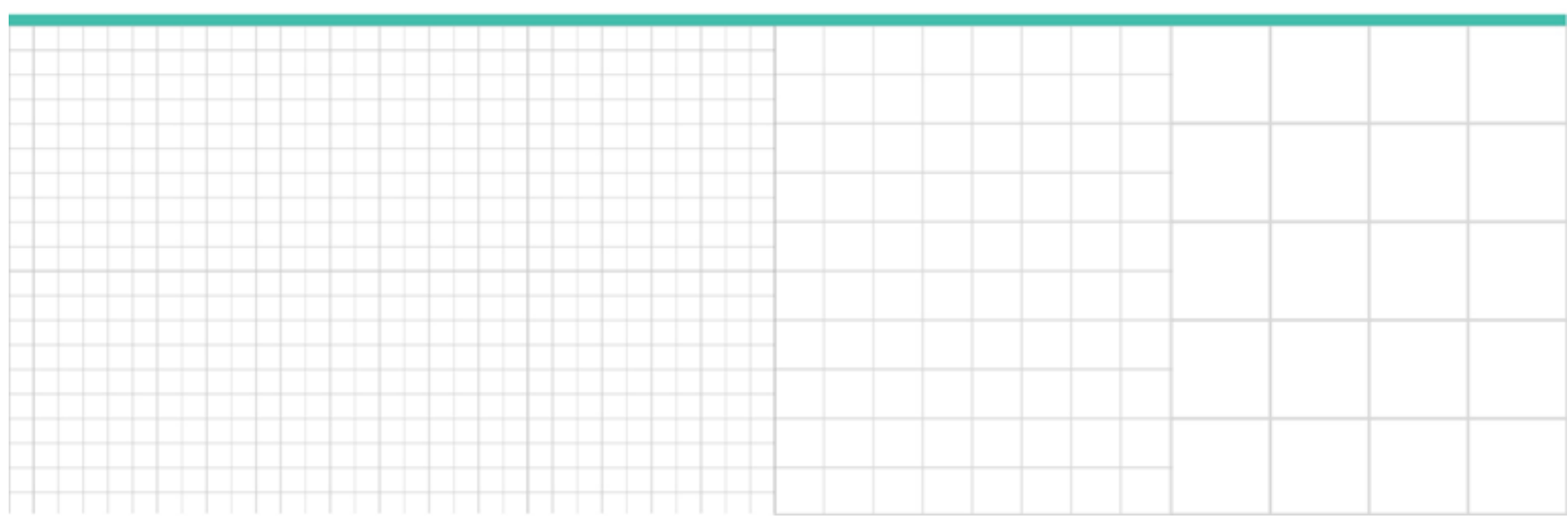


**Bloomberg
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Guide to Retirement Plan Designs

**Defined Benefits
Plans:
Chapter 9.
Underfunded
Plans**



Chapter 9. Underfunded Plans



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.10 UNDERFUNDED PLAN BASICS

.10.10 What is an Underfunded Plan? —

“The pension plan is 90 percent funded.” Not so fast! That statement can easily mislead the sponsor of the plan or a number of other interested parties, including a lender, an investor, or a prospective buyer in the case of an M&A transaction. Depending on the purpose for which the funding level of a plan is determined and the assumptions and methods used, the funding level of a given plan can vary widely. For example, a plan that is significantly

overfunded based on the rules governing minimum required contributions can be significantly *underfunded* based on the rules governing standard terminations, which require funding sufficient to pay out all benefits.

There are many different purposes for determining the funding level of a pension plan, with different results. A plan may well be “90 percent funded” for one purpose, but have a *very* different funding level — perhaps “70 percent funded” or “110 percent funded” — for another.

This chapter will provide an overview of the most common purposes for which the funding level of a single-employer PBGC-covered pension plan is determined, how assets and liabilities are determined for each of these purposes, what the key consequences are if a plan is underfunded for one or more of these purposes, what the key consequences are if the employer has failed to satisfy the minimum funding requirements for the plan, and what the key options are for dealing with unaffordable contributions. For a discussion of funding rules for multiemployer pension plans, see *Collectively Bargained Multiemployer Pension Plans*.

Additional Resources: [357 T.M.](#), *Pension Plan Terminations—Single Employer Plans*; [380 T.M.](#), *Employee Benefits in Bankruptcy*.

.10.20 Key Differences Among Various Measures of Plan Funding Levels —

As mentioned above, any reference to a pension plan's funding level has virtually no meaning without taking into account the purpose for which the funding determination is made. In addition, the following must be known: (1) the date as of which the plan's funding level was determined (the “valuation date” or the “measurement date”); (2) how the value of the plan's assets was determined; and (3) how the value of the plan's liability for benefits was determined. Consider the following:

- *Purpose of determination:* Different purposes for determining the funding level of the plan may call for dramatically different assumptions and methods for valuing the plan's assets and liabilities. Various assumptions and methods are prescribed, and the actuary valuing the plan's liability is instructed to consider the purpose of the measurement when selecting economic assumptions other than those that are prescribed.¹
- *Valuation/measurement date:* The funding level of the plan can change, sometimes dramatically, from one date to another, even if the two dates are not far apart, perhaps based on market gains or losses, changes in the interest rates used to value the plan's liability for benefits, a significant business event such as a reduction in force, or demographic changes among the plan's participants (*e.g.*, the premature death(s) of a participant or of several participants, which actuaries may treat as “favorable” mortality experience for the plan).
- *Valuation of plan assets:* In some cases, the value of the plan's assets is determined based on the fair market value of assets as of the valuation date, whereas in other cases it is based on an “actuarial” value that allows for the smoothing of market values by considering market experience over a prescribed period of time, subject to specified limits, as of two or more dates. When there are dramatic changes in investment experience from one period to the next, the difference between fair market value and actuarial value can be significant. And in some cases, the value of plan assets as of the valuation date takes into account the value, as of that date, of contributions receivable, whereas in other cases contributions receivable are disregarded.
- *Valuation of the plan's liability for benefits.* In some cases, the value of the plan's liability for benefits focuses on its liability for all benefits, whereas in other cases the focus is limited to vested benefits. And in some cases, the value takes into account the effect of future changes in compensation levels on the liability for benefits, whereas in other cases the effect of such future changes is disregarded. Also, with the value of the plan's liability for benefits significantly affected by the choice of interest rates to discount future expected benefit payments to the valuation or measurement date, different discount rates used for different purposes can lead

to very different values. For example, in the case of a plan with a liability-weighted average duration of its liabilities of 10-years, a 100-basis-point increase in the interest rate(s) used to value liabilities can lead to a decrease of about 10 percent in that value and, conversely, a 100-basis-point decrease in the interest rate(s) can lead to an increase of about 10 percent.

¹ Actuarial Standard of Practice No. 27, Section 3.6.a.

Practice Tip: It is therefore of critical importance to know *as of when* and *how* a plan's funding level was determined, not just *what* the plan's funding level was determined to be.

.10.30 Minimum Funding Basis —

The valuation date used to determine the plan's funding level for purposes of complying with the minimum funding rules for a plan year is the first day of that plan year, subject to an exception for small plans (generally, those with 100 or fewer participants).² The plan's enrolled actuary will determine, as of the valuation date:

² I.R.C. § 430(g)(2).

- the value of the plan's assets;³
- the plan's "funding target" (generally, the present value of all benefits accrued or earned under the plan as of the beginning of the plan year, without taking into account the effect of future changes in compensation levels);⁴ and
- the plan's "target normal cost" (generally, the present value of all benefits that are expected to accrue or to be earned under the plan during the plan year, plus the amount of plan-related expenses expected to be paid from plan assets during the plan year).⁵

³ I.R.C. § 430(g)(3).

⁴ I.R.C. § 430(d).

⁵ I.R.C. § 430(b).

The funding level of the plan for minimum funding purposes is generally determined by comparing the value of the plan's assets to its funding target, and is referred to as the plan's Funding Target Attainment Percentage (FTAP).⁶

⁶ I.R.C. § 430(d).

The minimum required contribution for a plan year is the sum of: (1) the plan's "shortfall amortization charge" for the plan year; and (2) the plan's target normal cost (as described above) for the plan year.⁷ The "shortfall amortization charge" for a plan year is generally tied to changes in the plan's funding levels (comparing the value of the plan's assets to its funding target) from plan year to plan year over an extended period, and is generally designed to fund those changes under a 15-year amortization schedule.⁸

⁷ I.R.C. § 430(a).

⁸ I.R.C. § 430(c).

The rules governing payment of the minimum required contribution for a plan year generally require four quarterly installments and one final "catch-up" payment. For a calendar-year plan, the quarterly installments are due on Apr. 15, Jul. 15, and Oct. 15 of the current plan year and Jan. 15 of the next plan year, and the final "catch-up"

payment is due on Sept. 15 of the next plan year.⁹

⁹ I.R.C. § 430(j).

The value of the plan's assets may be based on their fair market value, taking into account the value of contributions receivable for the preceding plan year.¹⁰ Or it may be based on an “actuarial value” by smoothing market experience over a period of up to (roughly) the past two years, subject to the limitation that such an “actuarial” value fall within a 10-percent corridor surrounding the fair market value as of the valuation date.¹¹ In either case, there are circumstances in which asset values may or must be reduced by the portion attributable to excess contributions for prior plan years, which can form a type of credit balance (referred to as a “funding standard carryover balance” or a “prefunding balance”).¹² The funding standard carryover balance reflects the amount of credit balance that was carried over from pre-2008 plan years, while the prefunding balance reflects excess contributions made for post-2007 plan years. These balances are subject to certain interest and investment experience adjustments and are reduced to the extent used to offset minimum required contributions.

¹⁰ I.R.C. § 430(g)(3)(A).

¹¹ I.R.C. § 430(g)(3)(B).

¹² I.R.C. § 430(f).

To determine the plan's funding target, the enrolled actuary uses a set of interest rates and specified mortality assumptions that are generally reasonably current (although larger plans may have credible experience that can justify different mortality), along with other actuarial assumptions (*e.g.*, when participants are expected to retire).¹³

¹³ I.R.C. § 430(h).

The enrolled actuary generally uses a set of “stabilized” interest rates to value benefits to be paid after the valuation date, with different rates to be used depending on when the benefit is expected to be paid (*i.e.*, within the next five years, within the fifteen-year period following that initial five-year period, or more than twenty years in the future).¹⁴ These rates are based on an average of yields on investment grade corporate bonds over a recent 24-month period, and are “stabilized” by requiring that the rates used for minimum funding purposes fall within a “corridor” (currently a 5 percent corridor) of their average over a recent 25-year period.

¹⁴ I.R.C. § 430(h)(2).

Practice Tip: This stabilization structure can serve to significantly increase or decrease the plan's funding level for minimum funding purposes as compared to what it would be without the application of any such stabilization, depending on interest rate trends during the recent 24-month period versus the recent 25-year period. Particularly where the interest rates over the recent 25-year period are significantly higher than they were over the recent 24-month period, the stabilization rules can serve to significantly reduce minimum required contributions. In practice, the stabilization structure has allowed for the use of higher rates (and lower liabilities) than if more current rates applied, thus reducing funding requirements for sponsors, but the sharp, significant increases in interest rates seen during 2022, if sustained, will erode or even eliminate the value of interest rate stabilization.

.10.40 Benefit Restriction Basis —

When a plan's funding level falls below specified thresholds, the plan may become subject to benefit restrictions. Those restrictions may: (1) prohibit the plan from adopting amendments which increase the plan's liability for benefits¹⁵ or from paying shutdown benefits or other “unpredictable contingent event” benefits;¹⁶ (2) limit or prohibit

the plan's ability to pay lump sums or certain other types of accelerated benefit distributions;¹⁷ or (3) prohibit the plan from continuing to provide benefit accruals.¹⁸ The funding level of the plan that governs whether these restrictions are triggered is the plan's Adjusted Funding Target Attainment Percentage (its AFTAP).

¹⁵ I.R.C. § 436(c).

¹⁶ I.R.C. § 436(b).

¹⁷ I.R.C. § 436(d).

¹⁸ I.R.C. § 436(e).

The starting point for determining the plan's AFTAP is its funding level as determined for minimum funding purposes, *i.e.*, its FTAP, subject to modifications in some cases relating to the treatment of any portion of the plan's asset value attributable to excess contributions for prior plan years. That modified or unmodified FTAP is converted to the plan's AFTAP by increasing both the numerator (*i.e.*, the value of the plan's assets) and the denominator (*i.e.*, the plan's funding target) by the aggregate amount of purchases of annuities for non-highly compensated employees that were made during the prior two plan years.¹⁹

¹⁹ I.R.C. § 436(j).

Example: A plan has an FTAP of 79 percent based on an asset value of \$7.9 million and a funding target of \$10 million. If the plan purchased \$2 million of annuities in the prior two years for non-highly compensated employees, its AFTAP would be higher than its 79 percent FTAP, *i.e.*, it would be 83.2 percent (based on adjusted assets of \$9.9 million and an adjusted funding target of \$11.9 million).

.10.50 PBGC Variable-Rate Premium Basis —

A PBGC-covered single-employer plan is subject not only to a flat-rate premium (based on its participant count), but also to a variable-rate premium (based on its funding level). When determining the funding level of the plan for purposes of determining its “unfunded vested benefits,” which forms the basis for calculating the variable-rate premium to be paid to the PBGC, the starting point is tied to the determination of the plan's funding level for minimum funding purposes as of the valuation date for the “premium payment year” (*e.g.*, in the case of a calendar year plan, generally Jan. 1, 2023, for the premium owed for the 2023 “premium payment year”).²⁰ However, there are significant modifications that may or must be made, most notably:

²⁰ 29 C.F.R. § 4006.4(a).

- *Valuation of plan assets:* Although for minimum funding purposes the value of plan assets may be determined based on an “actuarial” value that takes into account some level of averaging of values over two or more dates, for PBGC premium purposes the fair market value of the plan's assets must be used.²¹
- *Benefits taken into account as part of funding target:* While the plan's funding target for minimum funding purposes takes into account non-vested benefits, the funding target for PBGC variable-rate premium purposes takes into account only vested benefits.²²
- *Inapplicability of stabilization rules:* The interest rates used to value the plan's funding target for premium purposes do not take into account the interest rate stabilization rules that apply for minimum funding purposes. Thus, in a declining interest rate environment, a plan will generally be less well-funded for variable-rate premium purposes than for minimum funding purposes.²³
- *Choice of time for determining interest rates:* There is a choice (subject to a five-year restriction on changing

the choice) of which sets of interest rates to use in valuing the funding target: (1) the “standard premium funding target,” which uses the non-stabilized minimum funding interest rates for the month before the month in which the premium payment year begins (e.g., the rates for Dec. 2022 in the case of calendar year plan determining its variable-rate premium for the 2023 premium payment year) rather than the average of those rates over a recent 24-month period, as is generally done for minimum funding purposes; or (2) the “alternative premium funding target,” which uses the rates that would have been used for minimum funding purposes if the stabilization rules did not apply (generally, an average of rates over a recent 24-month period).²⁴

²¹ 29 C.F.R. § 4006.4(c).

²² 29 C.F.R. § 4006.4(b)(2)(i).

²³ 29 C.F.R. § 4006.4(b)(2)(ii).

²⁴ 29 C.F.R. § 4006.5(g).

Practice Tip: Thus, in a declining interest rate environment, a plan will generally be better funded using the alternative premium funding target (as the higher rates over the recent 24-month period will result in lower liabilities), and vice versa.

For more on PBGC variable-rate premiums, see [Variable Rate Premiums](#).

.10.60 Financial Statement Basis —

Accounting for pensions is governed generally by the Financial Accounting Standards Board (FASB). In particular, corporate accounting for pensions is governed by Accounting Standard Codification (ASC) Topic 715, while plan accounting is governed by ASC Topic 960. In general, plan sponsors and others will be concerned primarily with [ASC 715](#). Only in very rare cases will management, shareholders, lenders or other creditors, or regulators put a high priority on [ASC 960](#).

Under [ASC 715](#), the actuary will calculate three measures of liability: the projected benefit obligation (PBO), which is calculated in much the same manner as the funding target, but takes into account expected future increases in compensation; the accumulated benefit obligation (ABO), which is calculated in the same manner as the funding target; and the vested benefit obligation (VBO), which is the vested portion of the ABO. For all of these calculations, the actuary is to choose an interest rate (sometimes referred to as a discount rate) that is based on high-quality corporate bonds (AA or higher) and that reasonably matches the expected future cash flow related to the liabilities.²⁵

²⁵ Accounting Standards Codification Topic 715-30.

The amount of expense (or income) that a plan sponsor records on its books for a fiscal year is determined under [ASC 715](#). This amount will be the sum of the service cost (analogous to target normal cost), interest cost (interest on the PBO), amortization of any unrecognized prior service cost (cost of plan amendments), and amortization of any unrecognized actuarial losses, minus the expected return on plan assets and the amortization of any unrecognized actuarial gains.

.10.70 Standard Termination Basis —

A plan sponsor can terminate a single-employer defined benefit pension plan if all of the criteria for a “standard termination” are satisfied.²⁶ One of those requirements is that the plan must have enough assets to satisfy all of the plan’s “benefit liabilities”²⁷ to participants and beneficiaries, which is generally done by paying lump sums or purchasing “irrevocable commitments” (essentially, annuity contracts) from an insurer.²⁸ It is common for the

employer to make a “top-up” contribution to the plan to ensure the necessary level of sufficiency.

²⁶ 29 C.F.R. § 4041.21(a).

²⁷ 29 C.F.R. § 4041.21(a).

²⁸ 29 C.F.R. § 4041.21(a)(4), 29 C.F.R. § 4041.28(a), 29 C.F.R. § 4041.28(c).

- *Valuation of lump sums*: The rules governing minimum lump sum values require use of specified mortality assumptions that are generally reasonably current.²⁹ They also require use of specified interest assumptions that generally mirror those used for minimum funding purposes, except that the interest rate stabilization rules are disregarded³⁰ (generally resulting, in a declining interest rate environment, in lump sums of greater value than that of the underlying benefit as determined for minimum funding purposes). The time for determining the applicable interest rate is dependent on the plan's provisions (subject to certain limitations.³¹ For example, a plan might provide that the applicable interest rate for a lump sum distribution in the 2023 plan year is based on the applicable interest rate for a month near the end of the 2022 plan year.
- *Cost of irrevocable commitments*: The cost of irrevocable commitments is simply what the insurer charges, with that cost fluctuating, sometimes significantly, as prevailing interest rates change.

²⁹ I.R.C. § 417(e)(3)(B).

³⁰ I.R.C. § 417(e)(3)(C).

³¹ I.R.C. § 417(e)(3)(C); 26 C.F.R. § 1.417(e)-1(d)(4).

Practice Tip: In general, the cost of irrevocable commitments will be greater than the cost of the underlying benefit as determined for minimum funding purposes.

For more on standard terminations, see [Plan Termination Rules and Procedures](#).

.10.80 PBGC Distress or Involuntary Termination Basis —

When the plan doesn't have sufficient assets to terminate as a standard termination, an alternative is a distress termination or a PBGC-initiated termination (often referred to as an “involuntary termination,” even though it is often done consensually pursuant to an agreement between the PBGC and the plan administrator). PBGC regulations prescribe how the funding level of the plan is to be determined.³² The key date is the plan's termination date, as the plan's assets and its benefit liabilities are determined as of that date. Plan assets are based on fair market value (net of pre-termination liabilities), which would include the value of receivables, and benefit liabilities are based on a set of actuarial assumptions and methods that the PBGC specifies as part of an effort to match what the benefits would cost if they were to be provided by an insurer via the purchase of irrevocable commitments. In general, the plan will be treated as being funded at a lower level for purposes of a distress or involuntary termination than for any of the above-described purposes.

³² 29 C.F.R. § 4044.41–29 C.F.R. § 4044.75.

For more on distress and involuntary terminations, see [Plan Termination Rules and Procedures](#).

.20 CONSEQUENCES OF HAVING AN UNDERFUNDED PLAN

.20.10 Financial Statements, Etc. —

The effect of having an underfunded plan on a company's financial statements varies significantly from sponsor to

sponsor. Negative effects can include a decline in the company's stock price, a reduction in credit rating, thereby affecting the company's ability to borrow or the interest rate at which it is able to borrow, or adverse implications for executive compensation. When advising companies that sponsor pension plans, particularly if those plans are underfunded or could become underfunded, advisors should look carefully at any restrictive covenants that might relate to the funding levels of those plans.

.20.20 Benefit Restrictions —

Generally, when the AFTAP for a plan falls below 60 percent, the plan may not permit future accruals as of a valuation date until such time as the AFTAP exceeds 60 percent,³³ the plan may not provide unpredictable contingent event benefits (generally, shutdown benefits),³⁴ and the plan may not accelerate the timing of benefit distributions (generally resulting in a prohibition against lump sum payments).³⁵

³³ I.R.C. § 436(e).

³⁴ I.R.C. § 436(b).

³⁵ I.R.C. § 436(d).

When the AFTAP for a plan exceeds 60 percent, but is less than 80 percent, the plan generally may not increase the rate of benefit accruals³⁶ and lump sum payments are limited to the lesser of: (1) 50 percent of the amount that could be paid without regard to any benefit restrictions; and (2) the present value, determined under guidance provided by the PBGC, of the maximum guarantee with respect to each participant under [ERISA section 4022](#).³⁷

³⁶ I.R.C. § 436(c)(1).

³⁷ I.R.C. § 436(d)(3).

.20.30 PBGC Variable-Rate Premium —

As indicated above, a plan that has unfunded vested benefits (UVBs) will generally be subject to a variable-rate premium (VRP) charge tied to the amount of its UVBs.³⁸ For premium payment years beginning after 2022, the rate is \$52 for each \$1,000 (or fraction thereof) of UVBs.³⁹ Thus, for example, a plan with \$50 million in UVBs would be subject to a VRP of \$2.6 million for the 2023 premium payment year.

³⁸ 29 C.F.R. § 4006.3(b)(1).

³⁹ See [PBGC, Premium Rates](#).

In addition, there is a per-participant cap on the variable-rate premium that also changes every year.⁴⁰ For premium payment years beginning in 2023, the per-participant cap is \$652,⁴¹ resulting in a variable-rate premium capped at \$652,000 for a plan with 1,000 participants. This per-participant cap creates an incentive for employers to reduce the number of participants by taking de-risking actions in the form of annuity purchases (buy-outs) or lump sum windows, the effect of which is to significantly reduce the variable-rate premium (in addition to reducing the flat-rate premium).

⁴⁰ 29 C.F.R. § 4006.3(b)(2).

⁴¹ See [PBGC Premium Rates](#).

For more on plan de-risking, see [Checklist - De-Risking Strategies for Defined Benefit Plans](#).

A lower cap may apply in the case of a plan maintained by a small employer, *i.e.*, where there are no more than 25 employees throughout the controlled group⁴² of the contributing sponsor of the plan as of the first day of the

premium payment year.⁴³ But a small employer maintaining a legacy pension plan with a large number of participants in pay-status and/or terminated vested participants may not benefit from this cap, as the cap itself is \$5 times the *square* of the flat-rate participant count. Consider the above example of a plan with \$50 million in UVBs and 1,000 participants, for which the *uncapped* variable-rate premium is \$2.6 million, and for which the *per-participant-capped* variable rate premium is \$652,000. If that plan is a legacy plan maintained by a (now) small employer with no more than 25 *employees* in the controlled group, the “small employer” cap would be a whopping \$5 million ($\$5 \times 1,000 \times 1,000$), much *higher* than the per-participant cap.

⁴² 29 C.F.R. § 4001.2.

⁴³ 29 C.F.R. § 4006.3(b)(3).

In most cases, it is the contributing sponsor or a member of its controlled group that ultimately bears the cost of the variable-rate premium,⁴⁴ although the payment may generally be paid from plan assets. Any expected payment of the flat-rate and/or variable-rate PBGC premium from plan assets is taken into account in determining the target normal cost of the plan, and thus generally results in an increase in minimum required funding contributions.

⁴⁴ 29 C.F.R. § 4007.12(a).

For more on PBGC variable-rate premiums, see [Variable Rate Premiums](#).

Plans that are subject to PBGC variable-rate premiums at the per participant cap will generally realize the largest reduction in premiums by reducing headcount, usually through annuity purchases in an annuity buy-out or lump sum windows. Where the variable-rate premium is below the per participant cap, there will be a reduction in premiums of \$52 (for post-2022 plan years) for each additional \$1,000 of contributions (determined as of the valuation date for the current plan year), based on excess contributions to the plan for the prior plan year. On the other hand, plans that are subject to the per participant cap must first reduce their underfunding before they realize reductions in premiums due to additional contributions.

Each of these aspects of the PBGC variable-rate premium can be illustrated by the following examples involving three plans, each of which has 1,000 participants for the 2023 premium plan year:

- **Example 1:** Plan A pays premiums at the per participant cap, for a total variable rate premium of \$652,000 ($1,000 \times \652). If Plan A had purchased annuities for 100 of its participants in an annuity buy-out late in 2022, it would have reduced its variable rate premiums to \$586,800 ($900 \times \652), resulting in savings of \$65,200 in the total variable rate premium.
- **Example 2:** Plan B has \$11 million in UVBs for the 2023 premium payment year. Therefore, its variable rate premium for the 2023 plan year is \$572,000 ($.052 \times \11 million). If the plan sponsor were to contribute an additional \$1 million (determined as of the valuation date for the 2023 plan year) for the 2022 plan year, that would reduce Plan B's variable rate premium to \$520,000 ($.052 \times \10 million), resulting in savings of \$52,000.
- **Example 3:** Plan C has UVBs of \$13 million for the 2023 premium payment year. Therefore, its uncapped variable-rate premium for the 2023 plan year is \$676,000 ($.052 \times \13 million), and its capped variable-rate premium for the 2023 plan year is \$652,000 ($1,000 \times \652). Excess contributions for the 2022 plan year would result in a reduction in the variable-rate premium only if the resulting UVBs for the 2023 plan year are less than \$12,538,461 ($\$652,000$ divided by $.052$). Even if the plan sponsor were to contribute an additional \$1 million (determined as of the valuation date for the 2023 plan year) for the 2022 plan year, only the amount after reducing UVBs to the per-participant cap level will serve to reduce variable rate premiums.

.20.40 ERISA § 4062(e) Exposure —

Under ERISA § 4062(e), an employer may face a significant liability when there is a permanent cessation of operations at a facility in any location that results in a greater than 15 percent workforce reduction (subject to many rules and exceptions).⁴⁵ However, there is an important exemption from this liability: it does not apply if the plan is at least 90 percent funded on a variable-rate premium basis for the plan year preceding the plan year in which the cessation of operations occurs.⁴⁶ Thus, an employer may want to maintain its plan at that level to guard against the possibility of facing ERISA § 4062(e) liability.

⁴⁵ ERISA § 4062(e).

⁴⁶ ERISA § 4062(e)(3)(B).

.20.50 Reportable Events —

PBGC regulations require that plan administrators and contributing sponsors report to the PBGC about a wide variety of events that may be indicative of a need to terminate a pension plan.⁴⁷ Some of these “reportable events” involve the plan and others involve the contributing sponsor of the plan or a member of its controlled group. Reporting is generally due within 30 days after the reportable event occurs.⁴⁸

⁴⁷ 29 C.F.R. Part 4043, Subparts A and B.

⁴⁸ 29 C.F.R. § 4043.20.

There are a number of reporting waivers available, however, including the “well-funded plan” waiver, which applies to five of the reportable events—active participant reduction,⁴⁹ distribution to a substantial owner,⁵⁰ change in controlled group,⁵¹ extraordinary dividend or stock redemption,⁵² and transfer of benefit liabilities.⁵³ That waiver applies if no variable-rate premium was required to pay for the plan for the plan year preceding the plan year in which the reportable event occurs.⁵⁴ Thus, keeping the plan well-funded enough to satisfy the well-funded plan waiver can help reduce reporting obligations.

⁴⁹ 29 C.F.R. § 4043.23(d)(3).

⁵⁰ 29 C.F.R. § 4043.27(d)(2).

⁵¹ 29 C.F.R. § 4043.29(b)(5).

⁵² 29 C.F.R. § 4043.31(c)(5).

⁵³ 29 C.F.R. § 4043.32(c)(3).

⁵⁴ 29 C.F.R. § 4043.10.

Where neither the contributing sponsor nor the controlled group member to which an event relates is a public company, PBGC regulations may require *advance* reporting of certain reportable events by the contributing sponsor of the plan,⁵⁵ with far more limited waivers available. However, such advance reporting is required only if, for the plan year(s) preceding the plan year in which the reportable event becomes effective, the plans maintained within the controlled group (disregarding plans with no underfunding on a PBGC variable-rate premium basis), in the aggregate, have more than \$50 million in UVBs and are funded on a PBGC variable-rate premium basis below 90 percent.⁵⁶ For a privately-held company, it can be important to ensure that the funding level(s) of its plan(s) not trigger potential advance reporting obligations.

⁵⁵ 29 C.F.R. § 4043.61(b)(1).

⁵⁶ 29 C.F.R. § 4043.61(b)(2), 29 C.F.R. § 4043.61(b)(3).

A failure to file a reportable event notice by the applicable deadline can lead to significant penalties.⁵⁷

⁵⁷ ERISA § 4071, 29 C.F.R. § 4071.3.

.20.60 ERISA § 4010 Annual Reporting to the PBGC —

ERISA § 4010 and implementing PBGC regulations require that a controlled group with pension plans that have significant funding problems file identifying, actuarial, and financial information for that controlled group's "Information Year" (generally, the controlled-group-wide fiscal year).⁵⁸ The report is generally due 105 days after the end of the Information Year.⁵⁹

⁵⁸ 29 C.F.R. Part 4010.

⁵⁹ 29 C.F.R. § 4010.10(a).

The most common trigger requiring such reporting is where any plan is less than 80 percent funded based on ERISA § 4010 rules. Those rules generally track the minimum funding rules, with the notable exception that the interest rate stabilization rules are disregarded.⁶⁰ Because the interest rate stabilization rules do not apply, a plan that is well above 80 percent funded under the minimum funding rules may *nevertheless* be treated as being less than 80 percent funded for purposes of ERISA § 4010 reporting, and thus may trigger this reporting obligation. For that reason, many employers aim to ensure that all controlled group plans are at least 80 percent funded for ERISA § 4010 purposes.

⁶⁰ 29 C.F.R. § 4010.4(a)(1), 29 C.F.R. § 4010.4(b)(1).

Where ERISA § 4010 reporting would be triggered solely because a plan is less than 80 percent funded based on ERISA § 4010 rules, such reporting is waived if: (1) the aggregate 4010 funding shortfall of all controlled group plans (disregarding plans with no 4010 funding shortfall) is no more than \$15 million,⁶¹ or (2) there are fewer than 500 participants in all controlled group plans (generally determined at the end of the plan year ending within the Information Year).⁶²

⁶¹ 29 C.F.R. § 4010.11(a).

⁶² 29 C.F.R. § 4010.11(b).

ERISA § 4010 reporting is also required where: (1) missed contributions, including interest, exceed \$1 million and the missed contribution that resulted in crossing over the \$1 million threshold is not made within ten days of its due date,⁶³ or (2) there have been minimum funding waivers totaling over \$1 million and any portion thereof remains outstanding at the end of the Information Year.⁶⁴ However, reporting is waived if, for the plan year ending within the Information Year, the missed contributions or minimum funding waiver applications (as applicable) were reported to the PBGC under 29 C.F.R. Part 4043 by the due date for the ERISA § 4010 filing.⁶⁵

⁶³ 29 C.F.R. § 4010.4(a)(2).

⁶⁴ 29 C.F.R. § 4010.4(a)(3).

⁶⁵ 29 C.F.R. § 4010.11(c).

As is the case with reportable events, a failure to file an ERISA § 4010 report by the applicable deadline can lead to significant penalties.⁶⁶

⁶⁶ ERISA § 4071, 29 C.F.R. § 4071.3.

.20.70 PBGC's "Early Warning Program" Monitoring —

The PBGC has an "Early Warning Program," sometimes referred to as its "Risk Mitigation Program," under which it regularly monitors corporate transactions or events that could affect a controlled group's ability to continue to support its pension plan.⁶⁷ Transactions or events that may be of concern to the PBGC include a change in the controlled group responsible for supporting a pension plan; a major divestiture by an employer that retains significantly underfunded pension liabilities; a leveraged buyout involving the purchase of a company using a large amount of secured debt; a substitution of secured debt for a significant amount of unsecured debt; and the payment of a very large dividend to shareholders.

⁶⁷ See [Risk Mitigation & Early Warning Program](#).

If the PBGC concludes that a transaction or other event could increase the risk of plan failure, it will work with the controlled group in an effort to structure financial protections to participants and the pension insurance program. Examples of such protections include cash contributions in excess of minimum funding requirements, letters of credit, security interests, and guarantees by a related party. The PBGC's primary leverage to obtain such protections on a negotiated basis is its ability, under [ERISA § 4042\(a\)\(4\)](#), to initiate an involuntary termination of a pension plan when it determines that its "possible long-run loss . . . with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated."

The focus of the PBGC's activities under the Early Warning Program is on plans with underfunding of \$50 million or more, or with 5,000 or more participants, determined on an aggregate controlled group basis. The PBGC may also review a transaction or event under this program for "other reasons as appropriate."⁶⁸

⁶⁸ 2011 [Enrolled Actuaries Meeting Questions to the PBGC and Summary of Their Responses](#), Q&A 19.

Practice Tip : At least for controlled groups with fewer than 5,000 participants, ensuring that its plan or plans not cross over the \$50 million underfunding threshold will help to minimize the likelihood of a potentially unwelcome intervention by the PBGC in the context of a transaction or other event.

For more on the Early Warning Program, see [PBGC's Early Warning Program](#).

.30 CONSEQUENCES OF MISSING MINIMUM FUNDING PAYMENTS

.30.10 ERISA Notice to Participants for Quarterly or Annual Payments Missed by 60 Days —

If there is a failure to make a required minimum funding payment (including a quarterly installment) before the 60th day following its due date, the employer is required to notify participants, beneficiaries, and alternate payees of the failure.⁶⁹ The notice must be furnished within a "reasonable" period of time after the failure.⁷⁰

⁶⁹ [ERISA § 101\(d\)](#).

⁷⁰ [U.S. Department of Labor's Reporting and Disclosure Guide for Employee Benefits Plans](#) at p. 10.

Practice Tip: Many loan covenants require compliance with minimum funding rules, and treat a failure to make a required minimum funding payment in a timely manner as an event of default. Plan sponsors and their advisors should be aware of all such covenants before intentionally missing a required minimum funding payment deadline.

.30.20 PBGC Reportable Event Notice for Quarterly or Annual Payments Missed by 31 Days —

If there is a failure to make a required minimum funding payment (including a quarterly installment) by its due date, the contributing sponsor and the plan administrator must file a reportable event notice with the PBGC.⁷¹ However, reporting is waived if: (1) the payment is made within 30 days after its due date; (2) the failure is solely because of the plan sponsor's failure to timely make a funding balance election; or (3), in the case of a failure to pay a quarterly installments, the plan had no more than 100 participants for whom flat-rate premiums were payable for the plan year preceding the plan year in which the failure occurred.⁷²

⁷¹ 29 C.F.R. § 4043.25(a).

⁷² 29 C.F.R. § 4043.25(c).

.30.30 Penalty Interest on Late Quarterly Payments —

Although the minimum required contribution for a plan year is determined as of the valuation date for the plan year, which is generally the first day of the plan year,⁷³ payments made on later dates are discounted to the valuation date when determining whether and to what extent the minimum required contribution has been satisfied.⁷⁴ In general, the interest rate used to discount such payments back to the valuation date is the “effective interest rate” for the plan year, which is essentially a single rate of interest that serves as a surrogate for the various interest rates used to value future benefit payments.⁷⁵ However, when a quarterly contribution is not paid by its due date, the discount rate that is used for the period from the date of payment back to the due date for the quarterly contribution is the effective interest rate *plus* 500 basis points.⁷⁶ In effect, there is a form of “penalty interest” on late quarterly contributions, which generally will result in an increase in the cash required to satisfy the minimum required contribution for the plan year.

⁷³ I.R.C. § 430(g)(1).

⁷⁴ I.R.C. § 430(j)(2).

⁷⁵ I.R.C. § 430(h)(2)(A), I.R.C. § 430(j)(2).

⁷⁶ I.R.C. § 430(j)(3)(A).

.30.40 Statutory Liens and PBGC Form 200 Reporting for Missed Quarterly or Annual Payments Totaling \$1M+ with Interest —

If the total missed contributions to a plan, including interest, exceeds \$1 million, a statutory lien in favor of the plan arises under I.R.C. § 430(k) in the amount of that total.⁷⁷ The lien is upon all property and rights to property of the contributing sponsor of the plan and of all members of its controlled group, and continues to exist until the end of the first plan year in which the total missed contributions, including interest, no longer exceeds \$1 million. The lien may be perfected and enforced by the PBGC. In appropriate circumstances, the PBGC may be willing to enter into a forbearance or subordination agreement relating to the lien. This lien does not apply if the plan is over 100 percent funded on a specified basis under the minimum funding rules.

⁷⁷ I.R.C. § 430(k).

If there is a failure to make a required minimum funding payment in a situation where this statutory lien arises, perhaps for a second or third time, or more, the contributing sponsor of the plan and its ultimate parent are required to file a [Form 200](#) with the PBGC to report the failure within 10 days after the due date for the required payment.⁷⁸ As is the case with reportable events and [ERISA § 4010](#) reports, a failure to file a PBGC Form 200 by the applicable deadline can lead to significant penalties.⁷⁹

⁷⁸ 29 C.F.R. § 4043.81.

⁷⁹ ERISA § 4071, 29 C.F.R. § 4071.3.

.30.50 Excise Taxes and IRS Form 5330 Reporting for Missed Annual Payments —

If there is a failure to satisfy the minimum funding requirement for a plan year by the applicable deadline (*e.g.*, in the case of a calendar-year plan, Sept. 15, 2024, for the minimum required contribution for the 2023 plan year), the employer is liable to IRS for an excise tax under I.R.C. § 4971(a)(1) in the amount of 10 percent of the aggregate unpaid minimum required contributions for that plan year and all preceding plan years. The excise tax is due, along with an IRS Form 5330 filing, by the 15th day of the tenth month after the end of the plan year (*e.g.*, Oct. 15, 2024, in the case of a failure to satisfy the minimum funding requirement for the 2023 calendar plan year).⁸⁰ There is also, thereafter, the possibility of a liability for an excise tax in the amount of 100 percent of the aggregate unpaid minimum required contributions for that plan year and all preceding plan years under I.R.C. § 4971(b), but there are various circumstances in which that 100 percent tax will not be owed.⁸¹

⁸⁰ Instructions for Form 5330 (Rev. Dec. 2021) at p. 2.

⁸¹ See I.R.C. § 4971(b)(1), I.R.C. § 4971(c)(2), I.R.C. § 4971(c)(3), I.R.C. § 4961(a), I.R.C. § 4963, and I.R.C. § 6212.

.30.60 PBGC Initiation of Involuntary Termination —

Under ERISA § 4042, the PBGC may initiate an involuntary termination of a plan in various circumstances, including where there is a failure to satisfy the minimum funding requirement for a plan year. Although the PBGC will not routinely initiate an involuntary termination when such a failure exists, the possibility that the PBGC might do so provides an added incentive to employers to ensure that the required minimum funding payment for a plan year is made by the final due date for doing so (*e.g.*, Sept. 15, 2024, for the 2023 calendar plan year).

.40 OPTIONS FOR DEALING WITH UNAFFORDABLE CONTRIBUTIONS

.40.10 Minimum Funding Waivers —

An employer facing unaffordable contributions may want to seek a minimum funding waiver from IRS under I.R.C. § 412(c). The term “waiver” is a bit of a misnomer in that the “waived” amount is just deferred rather than forever waived; the amount due for a particular plan year is waived for *that* plan year, but then has to be repaid, with interest, over the next five plan years, on top of the minimum required contribution for each of the next five plan years.

Practice Tip: In effect, a waiver is essentially a “loan” from the plan to the employer. Except where the aggregate unpaid minimum required contributions at issue for all plan years is less than \$1 million, the IRS will generally require that the employer provide security for this “loan” that is acceptable to the PBGC, and will consult with the PBGC (and give considerable weight to the PBGC's views) in connection with the waiver application process. However, that can still be helpful in getting an employer through some tough times, particularly if the IRS were to grant waivers for multiple plan years. The (IRS can grant waivers for up to three plan years out of any consecutive 15 plan years).⁸²

⁸² I.R.C. § 412(c)(1)(A).

The substantive test for a waiver requires a showing that the employer cannot meet minimum funding requirements for a particular plan year without “temporary substantial business hardship,” which translates into a two-part test:

(1) that there would be a “substantial business hardship” if the employer had to meet minimum funding requirements for that plan year without a waiver being granted; and (2) that the hardship is “temporary,” which essentially means that the employer can show what is loosely referred to as “bounce-back,” *i.e.*, the employer has reasonable projections showing an ability to repay the waived amount (on top of meeting its regular minimum funding obligations) over the next 5 years.

The factors IRS takes into account in determining temporary substantial business hardship include whether or not: the employer is operating at an economic loss, there is substantial unemployment or underemployment in the trade or business and in the industry concerned, the sales and profits of the industry concerned are depressed or declining, and it is reasonable to expect that the plan will be continued only if the waiver is granted.⁸³

⁸³ I.R.C. § 412(c)(2).

An application for a waiver with respect to a plan year must be submitted no later than the 15th day of the 3rd month beginning after the close of the plan year (*e.g.*, by March 15, 2024, for a waiver relating to the minimum required contribution for the 2023 calendar plan year).⁸⁴

⁸⁴ I.R.C. § 412(c)(5)(A).

.40.20 Distress Terminations —

If the responsible controlled group is facing unaffordable minimum funding contributions, a bankruptcy filing may be the right solution, at least where there are other liabilities that cannot be satisfied. In such circumstances, a distress termination under the “bankruptcy reorganization” test in [ERISA § 4041\(c\)\(2\)\(B\)\(ii\)](#) may allow the controlled group members to emerge from bankruptcy with their pension liabilities, and other liabilities, largely or entirely resolved. Under that test, among other requirements, the bankruptcy court (or other appropriate court) must determine that “unless the plan is terminated, [the controlled group member] will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process.” Each member of the responsible controlled group (subject to an exception for certain shell entities) must meet either this bankruptcy reorganization distress test or one of the other distress tests (generally involving liquidation, inability to continue in business if the pension plan remains ongoing, or unreasonably burdensome pension costs).

However, bankruptcy can be a very difficult and expensive process with unpredictable outcomes. For that reason, employers may want to consider an out-of-bankruptcy solution by pursuing a distress termination under the “business continuation” test in [ERISA § 4041\(c\)\(2\)\(B\)\(iii\)\(I\)](#), based on demonstrating to the PBGC that, “unless a distress termination occurs, such [member] will be unable to pay such [member]’s debts when due and will be unable to continue in business.” If the PBGC approves a distress termination, the responsible controlled group members will face a liability that is generally far greater than the liability for contributions that led to the distress termination filing: a liability to the PBGC for the entire underfunding in the plan based on conservative PBGC assumptions, along with a “termination premium” totaling \$1,250 per participant, per year, for three years.

Practice Tip: If the PBGC approves a distress termination application that was based on the employer’s goal of continuing in business once it resolves its pension-related liabilities, it is unlikely to insist on a settlement structure that would result in the employer being unable to continue in business. For this reason, distress termination liability settlements with the PBGC focus on what the employer can afford to pay to the PBGC and still remain in business.