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PBGC Distress and Involuntary Terminations: A Brief Overview and Some Observations

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Most terminations of PBGC-covered single-employer pension plans are "standard terminations," with the plan having sufficient assets to provide participants with 100% of the plan's "benefit liabilities." But there are two other termination categories where the plan need not have, and typically falls far short of having, that level of assets: distress and involuntary terminations. These terminations can result in significant liabilities for the plan sponsor and its affiliates and potentially large benefit cutbacks for some plan participants.

A distress termination is a voluntary termination and is initiated by the plan administrator at the behest of the sponsor, whereas an involuntary termination is initiated by PBGC and, while generally labeled as involuntary, is often done by agreement. (An involuntary termination done by agreement is oxymoronically called a "consensual involuntary termination.") The requirements to qualify for these two types of termination differ, but the end result is identical in most respects in terms of liabilities and in all respects in terms of the effect on participant benefits.

To qualify for a distress termination, the sponsor and each of its controlled group members must each meet at least one of the four distress tests:

- Distress Test 1: Liquidation in bankruptcy/insolvency;
- Distress Test 2: Reorganization in bankruptcy;
- Distress Test 3: Inability to continue in business; or
- Distress Test 4: Pension costs have become unreasonably burdensome due solely to the decline in its workforce covered by its single-employer plans.

This article will focus on Distress Test 3, but will start with just a few words about the other three tests. Distress Test 1, liquidation in bankruptcy/insolvency, is essentially automatic. For Distress Test 2, you have to convince a bankruptcy judge that the only way you can successfully reorganize is if the plan is terminated. And you can generally ignore Distress Test 4, since it's very rarely used because of the difficulty of meeting the requirement that the distress is due "solely" to the workforce decline.

Distress Test 3 is analogous to Distress Test 2, except that: (1) it virtually always occurs outside of bankruptcy; and (2) the argument, which goes to PBGC instead of a bankruptcy judge, is that termination is needed to allow for continuation in business rather than to allow for a successful reorganization. One might wonder, "What's the point of pursuing a Distress Test 3 case?" If you can't afford your ongoing plan and it's terminated outside of bankruptcy, your liabilities get even higher because of what you'll then owe PBGC, and you can't satisfy those liabilities with cents on the dollar based on the bankruptcy process, so why bother? The answer is simple — PBGC fully recognizes that the purpose of Distress Test 3 is to allow for business continuation and will aim to settle your liabilities in a way that allows you to do so.

That said, in a Distress Test 3 case outside of bankruptcy, PBGC may not be sharing the pain with other creditors in the way it would in a bankruptcy. You should therefore explain to PBGC why bankruptcy isn't a good option, or perhaps that there has been some sharing of the pain outside of bankruptcy through negotiations with key creditors.

What PBGC is looking for is that you've done everything you can to try to afford the plan and that a distress termination is truly your last resort. Just make sure you demonstrate not only that you have enough distress to show you can't continue in business with the plan ongoing, but that you don't have so much distress that you couldn't continue in business with the plan terminated, even if PBGC agreed to a settlement where you pay zero dollars.

Your case to PBGC will be based largely on your contribution projections and your financial projections. For both sets of projections, you may want to show a range of results, for example, with your projected contributions varying significantly based on differing interest rate and investment return scenarios. Build in the timing of making up any missed contributions and address the possibility of asking IRS for a funding waiver — which in most cases won't help unless the distress is temporary, since a funding waiver is ultimately a deferral, not a waiver. For your financial projections, be specific about the underlying assumptions. PBGC may question those assumptions or substitute its own assumptions, perhaps developed by an expert industry consultant retained by PBGC.

As part of demonstrating that you can continue in business if the plan is terminated, you may want to build in an assumed PBGC settlement that's affordable. PBGC will likely treat that as your first settlement offer, so make sure it's reasonable, but there's no need to be overly generous – after all, it's just your first offer!

The distress process to some extent tracks the standard termination steps. But there's a first step that doesn't track those steps; while it's optional, I highly recommend you take advantage of it. Schedule a pre-filing consultation with PBGC so that you can present a high-level summary of your case, get what may be very helpful feedback, and find out whether PBGC may be willing to simplify or expedite some of the steps.

The official start of the process is when you send participants a notice of intent to terminate. I generally recommend including additional information by providing a separate memo or a set of FAQs where you explain why you're pursuing a distress termination and what the effect will be on their benefits. In many cases, that will be good news for most participants, since PBGC will often cover most or all of their benefits.

The distress termination process can take a long time. The distress termination regulation imposes several time limits on the filer, but not on PBGC. Fortunately, PBGC can move very quickly and is likely to be responsive if you explain why there's a need for speed. And one thing *you* can do to speed up the process is to file Form 601, which is generally an easy filing (as it asks for very little other than a certification by the plan actuary as to the level of sufficiency of the plan for guaranteed benefits or for benefit liabilities), as soon as practicable—generally promptly after the proposed termination date—even though Form 601 isn't due until 120 days after the proposed termination date.

Throughout the process, you'll be dealing with the case team, consisting of PBGC lawyers, financial analysts, and actuaries. They'll have numerous questions and will ultimately make a recommendation about the distress termination application to an interdepartmental committee known as the TWG, or Trusteeship Working Group.

As you go through the process, remember that you're still dealing with an ongoing pension plan. However, once you issue your Notice of Intent to Terminate to participants, the rules say no loans to participants, no lump sums (except for death benefits and benefits attributable to employee contributions), no purchases of irrevocable commitments, and no premium payments from plan assets — that's because the liability is then solely with the sponsor and its controlled group members.

You're required to implement benefit cutbacks to estimated guaranteed levels or estimated asset-backed levels as of the proposed termination date based on detailed regulatory rules. These cutbacks may be more severe than appropriate; if so, ask PBGC to modify the cutbacks to make them work better, something PBGC can do under its regulations.

And remember that any ongoing failure to satisfy minimum funding requirements can lead to excise taxes when you miss an annual amount and to the creation of, or an increase in, an IRC Section 430(k) lien when you miss a quarterly or annual amount. Also, once PBGC becomes the statutory trustee, get PBGC's approval before paying any plan expenses, even routine expenses.

Your goal, of course, is to reach an affordable settlement with PBGC. At some point, the case team will hopefully say, "We have good news, PBGC has approved your distress termination application and accepted your proposed termination date, and here's a termination and trusteeship agreement under which the plan will be terminated, and PBGC will take over as the plan's trustee." Don't sign that agreement until you have a settlement in place with PBGC. Why? Because the instant you sign that agreement, you create huge liabilities, and you probably won't want to create those liabilities until they're settled. Although PBGC could go to court to force the termination to occur before a settlement is in place, it is unlikely PBGC would do that in a business continuation case.

You'll need releases from PBGC wearing two different hats — as statutory guarantor and as statutory trustee. As statutory guarantor, PBGC should release you from liability for the plan's unfunded benefit liabilities ("UBL"), which is often a surprisingly large number; for any unpaid regular premiums; and for the termination premium (which, at $3,750 a head, can also be a large number). You may also want PBGC, as statutory guarantor (and as regulator), to release you from any penalties for reportable events or other reporting failures. And as statutory trustee, PBGC should release you from liability for any unpaid minimum funding contributions (referred to by PBGC as its "DUEC" claim relating to "Due and Unpaid Employer Contributions").

Another release you might want to get, but probably won't get, is a release from liability for any fiduciary breaches. PBGC likes to hold on to that so that it has time to determine, after it's taken over the plan as statutory trustee, whether there were any such breaches. So my advice for your clients is straightforward: "don't commit fiduciary breaches!"

One problem area is liability for minimum funding excise taxes, since IRS, not PBGC, has control over that. For contributions with annual funding deadlines in the future, when you work things out with PBGC, there may be ways to document the agreements with PBGC to help ensure that IRS won't pursue excise taxes, but the analysis becomes more complex if the annual funding deadlines have already been missed.

The PBGC case team may be willing to discuss settlement even before it makes a formal recommendation to approve your application. Take advantage of that, as it can take a long time to reach and document a settlement. The easiest settlements involve just a one-time payment. If payments are to be made over time, particularly if the amounts are to be determined, such as where they depend on future profits, things can get complicated, and PBGC will likely insist on some form of security.

And in deciding what to offer, I generally wouldn't focus at all on what percentage of the PBGC liability you're offering to satisfy. If all you can afford to pay is $100,000, it doesn't matter whether the PBGC liability is $200,000 or $200,000,000 — the focus should be on what you can afford to pay in order to continue in business, which is the overriding purpose of the whole case. However, if it's important to know the amount of PBGC's UBL claim, ask PBGC to provide you with its PIP, or Pension Information Profile, and the underlying Excel spreadsheet so that you can focus on, and perhaps question or try to change, some of PBGC's key underlying assumptions. Or you can have the plan actuary do an estimate, or even a full valuation, as of the termination date.

I'll now briefly touch on the other category of terminations for PBGC-covered single-employer plans, involuntary terminations. PBGC can pursue an involuntary termination by issuing a notice of determination, or "NOD," stating that at least one of four criteria is met:

- Criterion One, a failure to meet the annual minimum funding standard;

- Criterion Two, a situation in which the plan will be unable to pay benefits when due (if it's currently unable, termination is mandatory);

- Criterion Three, a substantial owner distribution reportable event has occurred, a criterion that PBGC has relied on very rarely, if at all; or

- Criterion Four, where PBGC's long-run loss is reasonably expected to increase unreasonably if the plan is not terminated, a criterion PBGC has often relied on as leverage when it sees a corporate transaction it strongly dislikes.

In some cases, PBGC may be willing to rely on the involuntary termination route as a shortcut to avoid the need for the full distress termination process, and that can be done by agreement.

Once PBGC issues a NOD, the plan is no longer able to pay, or liable to pay, PBGC premiums, and once the plan is terminated, the same liabilities arise as in any distress termination other than a distress termination implemented solely under Distress Test 1 (as the termination premium claim applies in all involuntary terminations, but does not apply in a distress termination implemented solely under Distress Test 1).

Finally, here are some terms and acronyms about what happens to participant benefits in a distress or involuntary termination.

PBGC always pays guaranteed benefits but also often pays at least a portion of nonguaranteed benefits.

- The Title IV Benefit adds nonguaranteed benefits covered by plan assets; in some cases, some or all of Priority Category 3 benefits (*i.e.*, generally, those benefits for participants who retired or were eligible to retire at least three years before plan termination, with the amount generally based on the lowest benefit applicable during the five-year period before plan termination) get paid even if the plan is grossly insufficient for Priority Category 4 guaranteed benefits.

- And the Termination Benefit adds ERISA Section 4022(c) benefits, which may cover a good portion of the benefits that are neither guaranteed nor covered by plan assets, *i.e.*, unfunded nonguaranteed benefits, or "UNB."

    - How much of the plan's unfunded nonguaranteed benefits get paid depends on PBGC's UBL claim recovery ratio (*e.g.*, if the applicable recovery ratio is 10%, the 4022(c) benefits will cover 10% of the plan's unfunded nonguaranteed benefits).

        - If the particular plan's unfunded nonguaranteed benefits—UNB, not UBL—exceed $20 million, PBGC's recovery on its UBL claim in the particular case establishes the recovery ratio.

        - Otherwise, what establishes the recovery ratio is PBGC's historical recovery experience over the past five years under something called the SPARR, or "small plan average recovery ratio."

To determine what PBGC guaranteed benefits are, remember the term "P-E-N-A-M-P."

- The P-E-N portion (which stands for the requirement that the benefit is a ***p****ension* benefit, that the participant has ***e****ntitlement* to the benefit, and that the benefit is ***n****onforfeitable*, all as detailed in Subpart A of 29 CFR Part 4022) focuses on what it takes for the benefit to be *guaranteeable*.

- But that doesn't mean it's *guaranteed*, since there are limits on how much of the *guaranteeable* benefit is *guaranteed*, and those limits are covered by the A-M-P portion (which stands for the "***a****ccrued* at normal" limit, the ***m****aximum* guarantee limit, and the ***p****hase-in* limit, all as detailed in Subpart B of 29 CFR Part 4022).

When does PBGC start paying benefits? Here, the acronym is EPRD, or the Earliest PBGC Retirement Date, which is no earlier than the earliest Annuity Starting Date under the plan and is generally not before age 55, although there are facts-and-circumstances exceptions.

And the forms in which PBGC pays benefits are a straight life annuity, a 5-year, 10-year, or 15-year certain and continuous benefit; a 50%, 75%, or 100% joint-and-survivor benefit; a 50% "Pop-Up" joint-and-survivor benefit; and the automatic form of benefit payable under the plan.

Hopefully, all of your terminations will be standard terminations so that you can avoid dealing with any of the foregoing issues. But if you do face issues relating to distress or involuntary terminations, The Wagner Law Group's Washington, DC office can assist you, as its professionals, in the aggregate, have more than 100 years of experience serving in senior positions at PBGC in litigation, regulations, legal policy, benefit policy, actuarial, financial, and ombuds functions, as well as more than 100 years of experience after leaving PBGC in representing clients with PBGC issues.