

TYPES NOT MAPPED YET July 14, 2017 | TTR not mapped yet | Lori W. Jones

# Forewarned is forearmed? PBGC FAQs clarify the use of the early warning program

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[The Pension Benefit Guaranty Corporation (PBGC) is an independent federal agency created by the Employee Retirement Income Security Act of 1974 (ERISA) to protect pension benefits in private-sector defined benefit plans. Such protection is provided via an insurance program funded in large part by premiums paid by defined benefit plan sponsors. If a defined benefit plan insured by the PBGC terminates without sufficient assets to fund plan benefits, the PBGC will pay participants their benefits up to the limits set by law.]

Section 4042(a)(4) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), authorizes the PBGC to terminate a defined benefit plan if it determines that the possible long-run loss to the PBGC is "reasonably expected to increase unreasonably if the plan is not terminated." Over 20 years ago the PBGC adopted the Early Warning Program as a means by which the PBGC can proactively identify and address problematic transactions involving plan sponsors that could result in increased liability for the PBGC.

### Technical Update 00-3

The Early Warning Program was first formally described in Technical Update 00-3. Technical Update 00-3 states that review of a transaction under the Early Warning Program will only be triggered if specified criteria are met. Transactions of concern to the PBGC include:

- Break-up of a controlled group;
- Transfer of significantly underfunded benefit liabilities in connection with the sale of a business;
- Leveraged buyouts;
- A major divestiture by an employer who retains significantly underfunded benefit liabilities;
- Payout of extraordinary dividends;
- Substitution of secured debt for a significant amount of previously unsecured debt.

### 2011 guidance

At the March 2011 Enrolled Actuaries Meeting, the PBGC indicated that it generally monitors plan sponsors with defined benefit plans that in the aggregate have \$50 million or more in underfunding or 5,000 or more participants. Moreover, the PBGC indicated that, depending on the circumstances, it may monitor employers for other reasons, as appropriate. At the May 4, 2011 meeting with representatives of the American Bar Association's Joint Committee on Employee Benefits, PBGC representatives confirmed that the PBGC does not consider itself bound by the Early Warning Program screening criteria set forth in Technical Update 00-3 and that monitoring of employers was ongoing even in the absence of a specific transaction. Prior to the 2011 meetings, practitioners commonly believed that the PBGC would only monitor a plan sponsor under the Early Warning Program in the context of a pending or completed transaction.

At the March 2011 Enrolled Actuaries Meeting, the PBGC also described the following procedures for review of a transaction under the Early Warning Program:

- The PBGC typically contacts the CFO of the employer.

- The PBGC sends an information request that includes a request for actuarial information on the pension plans and information about the transaction, including financial information on the plan sponsor, information about the nature and timing of the transaction, and information regarding how the controlled group may be impacted by the transaction.
- If appropriate, the PBGC negotiates with the employer to reach a settlement designed to ensure the continuity of the plan after the transaction.
- The PBGC has flexibility to structure settlements that mitigate the risk to a defined benefit plans while still working within the parameters of employer's business plans.

## December 2016 update

In December 2016, the PBGC issued updated information with respect to the Early Warning Program that appeared to expand the circumstances which might trigger review under the Early Warning Program. These circumstances included the credit deterioration of the plan sponsor or a downward trend in cash flow or other financial factors of the plan sponsor. The apparent expansion of the review criteria engendered a strong response from benefit practitioners. On December 30, 2016, the PBGC Participant and Plan Sponsor Advocate addressed the update as follows:

Although PBGC has historically taken into account a company's "creditworthiness" or other financial factors relating to the company under the Early Warning Program, it did so in the context of a particular transaction. Now it appears that such factors may be the basis for any Early Warning Program demand absent a particular transaction. For plan sponsors, that is a troubling expansion of the reach of the Early Warning Program. As a result, PBGC may be contacting employers to request that the employer make an excess contribution to the plan or provide some other form of protection to PBGC and/or the plan, in the absence of any transaction, and threaten involuntary termination of the plan if the employer refuses, making it almost impossible for the employer to overcome financial difficulties. [\[2016 Annual Report of the Participant and Plan Sponsor Advocate, December 30, 2016, p. 9.\]](#)

In an [April 24, 2017, letter](#) to the PBGC, the American Benefits Council noted that under the expanded Program "almost every company in the country could be subject to the Early Warning Program."

## May 2017 FAQs

In response to feedback received with respect to its December 2016 update, on May 10, 2017, the PBGC issued additional information with respect to the Early Warning Program that included FAQs (2017 FAQs) responding to the most common questions received by the PBGC with respect to its Early Warning Program.

In the 2017 FAQs the PBGC states that the December 2016 update did not expand the Early Warning Program and clarifies that a change in a plan sponsor's credit rating will not itself trigger a review under the Early Warning Program. However, if a plan sponsor enters into, or announces, a transaction, the PBGC generally includes the plan sponsor's credit rating as part of its analysis of the transaction. If a plan sponsor has a high credit rating or if pending transaction does not result in a downgraded credit rating, the PBGC is less likely to review the potential impact of the plan sponsor's transaction on the defined benefit plan.

The 2017 FAQs also note that, for the first time, the PBGC website includes the following link to the standard information request that the PBGC issues under the Early Warning Program: ([View a sample information request form.](#))

The PBGC website also clarifies that the PBGC information request generally includes the following:

- Transaction - Information about the pending or completed transaction so that it can determine how the transaction will affect the plan sponsor and other participating employers and the cash flow available to support the defined benefit plan.
- Control Group - Information about the ownership structure of the plan sponsor and all other members of the controlled group (before and after the transaction) to determine possible sources of financial support for the defined benefit plan.
- Credit Quality - Current and projected financial information for the plan sponsor and controlled group members in order to assess the risk that the transaction will adversely impact the financial health of the controlled group.
- Plan - The most recent actuarial valuation report and plan asset valuation, contribution history, and information about recent events that have had a material effect on the defined benefit plan since the last actuarial valuation.

With respect to prior guidance indicating that the PBGC monitors plan sponsors with defined benefit plans that have \$50 million or more in underfunding or 5,000 or more participants, the 2017 FAQs clarify that the PBGC applies the underfunding and participant count thresholds on an aggregate controlled group basis.

The 2017 FAQs describe four potential outcomes of a PBGC review under the Early Warning Program:

- The PBGC conducts an internal review and closes the case without contacting the plan sponsor because the transaction poses no risk to the PBGC or plan participants.
- After an internal review, the PBGC identifies potential risks and contacts the plan sponsor to request information about the plan sponsor and the defined benefit plan. If the information indicates no increased risk of loss to the PBGC or plan participants, the review will be closed.
- If, after contacting the plan sponsor, the PBGC concludes there is increased risk, the PBGC and the plan sponsor negotiate and the plan sponsor makes increased contributions to the plan without a formal Early Warning Program agreement.
- After negotiating, the PBGC and the plan sponsor enter into an Early Warning Program agreement setting forth protections for the defined benefit plan.

The PBGC website indicates that protections that the PBGC may negotiate on behalf of defined benefit plan participants include the following:

- Cash contributions - The PBGC may require a plan sponsor to make cash contributions in excess of the minimum funding requirements for the plan.
- Letters of credit - The PBGC may request the plans sponsor to provide a letter of credit to secure an agreement to make future contributions to the plan or to secure a plan's unfunded liabilities.
- Security interests - The PBGC may request a plan sponsor to grant it a security interest in certain assets of the plan sponsor.
- Guarantees - The PBGC may request an entity related to the plan sponsor to assume the defined benefit plan or guarantee payment of pension obligations in the event the plan is terminated and the plan sponsor cannot pay all unfunded pension obligations.

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Because ERISA Section 4042(a)(4) authorizes the PBGC to terminate a plan if it determines there is a risk of long-term loss to the PBGC, the PBGC has significant leverage in negotiating an agreement under the Early Warning Program.

The May 11, 2017, FAQs also discuss the impact of a Form 4010 filing under the Early Warning Program. Section 4010 of ERISA requires plan sponsors of certain underfunded defined benefit plans and plan sponsors that have missed contributions or applied for funding waivers to report certain financial and actuarial information to the PBGC. This information is provided on Form 4010. The 2017 FAQs clarify that the filing of a Form 4010 will not itself trigger a review under the Early Warning Program. However, if a Form 4010 has been filed, the PBGC may use such information if the PBGC opens a review of a transaction under the Early Warning Program.

According to the PBGC website, each year under the Early Warning Program the PBGC identifies approximately 100 transactions that are potentially "of concern" and warrant requests for information from a defined benefit plan sponsor. Of the transactions, only about 5% result in formal settlement agreements between the PBGC and the plan sponsor.

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