Joint Committee on Employee Benefits Q&A
with the Pension Benefit Guaranty Corporation
based on meeting with staff
May 10, 2000

The following questions and answers are based on informal discussions between private-sector representatives of the JCEB and PBGC officials. The questions were submitted by ABA members, and the responses were given at a meeting of JCEB and government representatives. The responses reflect the unofficial, individual views of the government participants as of the time of the discussion and do not necessarily represent agency policy. This report on the discussions was prepared by designated JCEB representatives at the meeting. The questions were submitted in advance to the agency, and it was understood that this report would be made available to the public.

PBGC Premiums

1. **Question:** Does PBGC continue to use the premium audit program?

   **Answer:** Yes.

   a. **Question:** How many audits have been performed during the last year?

      **Answer:** Approximately 100. The PBGC is unable to perform more audits because of budgetary limits. PBGC decides which plans to audit based on an audit sample that compares the premiums paid over a two-year period. Samples are also chosen based on participant count discrepancies between the PBGC Form-1 and the Form 5500.

   b. **Question:** What percentage of audited plans had underpaid premiums?

      **Answer:** Approximately 50%. The amount of the underpayment ranges up to $1.5 million, including penalties and interest.

   c. **Question:** What are the primary reasons for underpayments?

      **Answer:** Errors in participant counts, particularly eligible and excludable employees. Also, the full funding exemption to the variable rate premium may be claimed inappropriately.

   d. **Question:** Have any changes been substituted or planned?

      **Answer:** No.
2. **Question:** Please describe the status of the PBGC’s proposed premium “self-audit” program. In particular, what would be the incentive for premium payors to take advantage of the program?

**Answer:** Pension practitioners have told the agency little interest exists in a premium self-audit program at present. Also, there is little incentive for plan sponsors to participate in such a program, given PBGC’s limited auditing efforts. PBGC is continuing to look at the issue and may put it out for comment.

3. **Question:** In view of the PBGC’s reported surplus of $7 billion, will PBGC consider any type of premium reduction legislation as an incentive for new plan creation?

**Answer:** Generally, no, in view of the risks that could be realized in a severe economic downturn. However, the Administration has proposed a lower flat rate for small plans, which would be $5/participant for the first five years. The variable rate that plan sponsors are paying is coming down because of the change to IRS interest rates.

4. **Question:** A non-covered plan (§4022(b)) inadvertently pays PBGC premiums, later becomes a covered plan and continues to pay premiums, and subsequently seeks a premium refund for non-covered years (subject to applicable statute of limitations). For example:

   - A “professional service employer” (§4021(b)(13)) had less than 26 employees from 1996 through 1998 and more than 25 employees in 1999 and thereafter, but paid premiums for all years.
   - A §501(c)(3) hospital maintained a “church plan” (§4021(b)(3)) from 1996 through 1998, but ceases its church affiliation in 1999 for business reasons unrelated to the plan, but paid premiums for all years.

What is the PBGC’s position on the refund of the erroneous premium payments if a refund request is filed during the 2000 premium payment year?

**Answer:** Refunds are permitted in both cases.

**Standard Terminations**

5. **Question:** Please describe the current status of PBGC’s post-termination audit program. What are the focus areas? What are the most frequent issues uncovered?

**Answer:** The focus areas are whether participants and beneficiaries received the proper benefits. The leading problem is wrong interest rate assumptions for lump-
sum distributions. Also, sometimes sponsors fail to obtain consents. There are also occasional improper post-termination plan amendments. Audits are conducted within six months to one year following the filing of a Post-Distribution Certification.

6. **Question:** May a defined benefit plan that terminates in a standard termination offer, as the only alternative for active participants who do not choose an annuity (immediate or deferred, depending on their ages), a transfer of the lump sum value of their accrued benefit to a defined contribution plan maintained by the employer? Is it permissible not to offer a lump sum at plan termination even if the plan offers them, or mandates them in the case of small benefits, upon termination of service?

**Answer:** These questions are within the IRS’s jurisdiction, not the PBGC’s.

7. **Question:** If a contributory plan terminates with surplus assets, should the participants’ share of the surplus be determined net of benefits that have already been distributed? The regulations under Section 4044 appear to indicate that category 2 benefits are determined net of benefits attributable to the employees’ share of the plan’s surplus reduced by the contributory benefits that have been paid out.

**Answer:** See §4044(d)(3)(C), which provides a three-year lookback for benefits that were distributed. See also H.Rep. No. Report No. 391, I, 100th Cong., 1st Sess., 130–32.

### Employer Liability/PBGC Enforcement

8. **Question:** Please describe the current status of PBGC’s "Early Warning System."

   a. **Question:** What criteria are used to track plans and sponsors?

   **Answer:** PBGC tracks companies with 5,000 or more participants in the controlled group that have underfunded plans based on PBGC’s termination assumptions. There are about 850 of these companies.

   b. **Question:** What activities will trigger PBGC action?

   **Answer:** Transactions involving those companies that could put the PBGC or plan participants at risk. Such corporate activities could include (1) controlled group break-up, (2) sale of a substantial part of a business (e.g., 10% of revenues or operating income), (3) recapitalization where all debt is secured, or (4) extraordinary dividends to shareholders. PBGC issued 210 letters in 1999 to such employers seeking pension and financial
information and obtained 12 settlements. PBGC will cease its efforts if it determines that the plan at issue would be sufficient on a terminating basis.

c. **Question:** What does PBGC require in typical situations in which it becomes involved?

**Answer:** PBGC looks at what is doable in each situation based on the transaction. The most common action is to ask the sponsor to make contributions that exceed the minimum funding requirements. This payment may be made all at once or over a period of years. This is then preserved as a credit balance for funding purposes.

In a controlled group break-up, the PBGC may either obtain a guarantee from the strongest company or require that it agree to assume the plan in the future. A risky sponsor may be required to provide a letter of credit to the PBGC or to pledge assets to protect the plan.

9. **Question:** Recently, PBGC’s semi-annual regulatory agenda referred to a plan to issue proposed regulations under §4062(e), imposing contingent liability on a sponsor involved in the cessation of operations at a facility. What is the status of this guidance?

**Answer:** This remains on the regulatory agenda but is not a priority.

10. **Question:** Please describe any recent situations in which the PBGC has determined that the principal purpose of a transaction is to evade liability under Title IV, pursuant to Section 4069.

**Answer:** : White Consolidated Industries. There have been two recent decisions, neither of which was reported, but which are available on Westlaw and LEXIS.

As PBGC reported: In this case buyer, Blau Knox Corporation, formed a new corporation that was not part of the buyer’s controlled group. Seller WCI then transferred its underfunded plans and certain retiree health liabilities to the newly created company. The consideration for this transaction was the buyer’s assumption of the liabilities for the underfunded plans. Under the agreement, the seller would continue to contribute to the buyer’s plans for five years.

PBGC had to terminate all six plans in the early 1990s because they either ran out of money or lacked sufficient funds to pay all benefits when due. PBGC filed suit against WCI in September 1991 to establish the company's liability for the underfunding of the Blau Knox pension plans.

The U.S. District Court in Pittsburgh held that WCI's transfer of the underfunded plans to Blau Knox Corporation was a sham transaction and that the company
ultimately became solely motivated by a desire to unload the BK Plans." 1999 WL 680185 (W.D.Pa., July 21, 1999). The court also held that a principal purpose of WCI in entering into the transaction was to evade its pension liabilities.

In the August 1999 ruling, reported at 72 F.Supp.2d 547 (W.D. Pa. 1999), the court ruled in favor of PBGC’s motion seeking to strike several of WCI’s defenses. The court, among other things, held that PBGC oral guidance to the plan sponsor was not binding on the agency and that the seller’s issuance of a reportable event notice to the PBGC did not begin the statute of limitations running on this matter.

WCI filed appeal to the 3rd Circuit, argued March, 2000. In addition, WCI submitted an appeal to PBGC challenging the agency's calculation of the amount of the plans' unfunded benefit liabilities.

Miscellaneous

11. **Question:** How does PBGC interpret the controlled group rules (§4001(b)) as they may apply to two or more non-stock, tax-exempt organizations? Does the PBGC subscribe to the IRS’s letter ruling position applying standards articulated under Code §512 in the absence of any authority under Code Section 414(b) and (c)?

**Answer:** PBGC has no answer, as they have not yet had to address the issue.

12. **Question:** Please describe the PBGC’s current proposals in its effort to revitalize the establishment and maintenance of defined benefit plans.

**Answer:** PBGC has no specific proposals at this time. Congress is paying attention to the importance of traditional defined benefit plans, given the number of cash balance plan conversions.

13. **Question:** What are the priority areas of PBGC’s legislative efforts?

**Answer:** One proposal is to treat very small businesses (25 and under) more favorably for variable rate premiums. Another is to obtain legislation to pay interest on premium overpayments/refunds. A third is to increase the level of guaranteed benefits under multi-employer plans.

14. **Question:** Please describe significant PBGC litigation in the past year that has established important precedent that would be of interest to benefits attorney.
Answer:

**Copperweld**: Employer filed bankruptcy 11/23/93, and pension plan terminated 9/30/95. PBGC filed priority claims in bankruptcy. PBGC hopes that the 6th Circuit will disagree with the 10th Circuit’s decision in In re CF & I Fabricators of Utah, Inc., 150 F.3d 1293 (10th Cir. 1998), and find that PBGC’s claims for due and unpaid employer contributions to pension plans are entitled to priority under the bankruptcy code.

**Panero**: Southern District of New York. Three decisions have been issued, reaching diametrically opposed results. 2000 WL 282894 (March 15, 2000); 1999 WL 195131 (April 7, 1999); 1999 WL 631221 (March 3, 1999).

In the most recent decision, the judge held that there was an inherent statutory conflict in Title IV of ERISA between PBGC performing its role as trustee of a private pension plan and its role as Title IV guarantor.

On April 24, 2000, the Court certified the case to the 2nd Circuit Court of Appeals to resolve this conflict.

PBGC argues that this litigation has very little to do with the fundamental issue in the case, which is whether participants are entitled to early retirement supplements when plan terminated before participants became entitled to supplements. There are no legislative proposals to guarantee such supplements if the participant has not qualified for supplement before plan termination.

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