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The Pension Benefit Guaranty Corporation and Single-Employer Plan Terminations

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Summary

Questions may arise regarding the pensions of private-sector workers and how pension plans may be terminated, particularly in instances where a company experiences financial difficulties. The Employee Retirement Income Security Act (ERISA) regulates plan terminations and provides for three types of single-employer plan terminations—standard, distress, and involuntary—and imposes different responsibilities on the Pension Benefit Guaranty Corporation (PBGC) for each type.

A standard termination occurs when a plan administrator decides to terminate a plan that has assets sufficient to meet its benefit liabilities. The PBGC's involvement in a standard termination is minimal, with its role basically limited to confirming all legal requirements have been met. In a standard termination, the plan sponsor has no further liability to the PBGC or plan participants. The sponsor may be able to recapture any assets remaining after participants have received their share, although the reversion may be subject to tax.

A distress termination occurs when a plan administrator seeks to terminate a plan that does not have sufficient assets to cover all the benefits owed to plan participants and beneficiaries. The PBGC is responsible for ensuring that all criteria for termination have been met, as well as for determining whether the plan's assets are sufficient to pay the guaranteed benefits and/or meet all benefit liabilities. Meanwhile, the plan sponsor and members of its controlled group are jointly and severally liable to the PBGC for the amount that the benefit liabilities exceed plan assets, with interest, at termination.

An involuntary termination occurs when the PBGC decides a plan should be terminated. The agency must initiate termination proceedings once it determines a plan does not have assets available to pay benefits currently due. It may seek termination under certain circumstances, including the plan has not met the minimum funding requirements; the plan will not be able to pay benefits when due; or the long-run loss to the PBGC may be expected to increase unreasonably if the plan is not terminated. In an involuntary termination, the sponsor and controlled group are jointly and severally liable to the PBGC for the unfunded liabilities.

The PBGC is broadly authorized to make any investigation it deems necessary to enforce ERISA and may assess a penalty against anyone who fails to provide a required notice or other material information. In addition, plan participants, beneficiaries, fiduciaries, and sponsors who are adversely affected by an action of another that violates the termination provisions may file suit in U.S. district court to enjoin the action or obtain other equitable relief. Employee organizations representing affected participants and beneficiaries are also able to file a claim, and the PBGC has the right to intervene in any action.

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In situations where a private-sector company goes out of business, questions may arise concerning how the company's pension plan may be terminated. The Employee Retirement Income Security Act of 1974 (ERISA), provides a comprehensive federal scheme for the regulation of pension and other employee benefit plans, and the Act includes a plan termination insurance program for defined benefit pension plans.¹ Various types of pension plans are not covered by the insurance program, including defined contribution plans (individual account plans),² government plans, and church plans.³ The insurance program distinguishes between single-employer plans and multiemployer plans (i.e., collectively bargained plans to which more than one company makes contributions). This report only discusses the termination of single-employer plans.⁴

The insurance program is administered by the Pension Benefit Guaranty Corporation (PBGC). The PBGC has two primary responsibilities. First, it oversees plan terminations, which is the focus of this report. Second, the PBGC pays certain guaranteed benefits under the plan, should the plan be terminated with insufficient funds to pay these benefits. For more information on the PBGC and its payment of benefits, see CRS Report 95-118, *Pension Benefit Guaranty Corporation (PBGC): A Primer*, by John J. Topoleski.

This report provides an overview of the three types of plan terminations and the PBGC's role in each type of termination. The report also provides a brief overview of the liability of an employer following a plan termination, enforcement and penalties relating to the plan termination provisions.

Types of Terminations

ERISA provides for three types of single-employer plan terminations: standard, distress, and involuntary. The plan administrator initiates a standard or distress termination, whereas the PBGC initiates an involuntary termination.

Standard Termination

A standard termination occurs when a plan administrator decides to terminate a plan that has assets sufficient to meet its benefit liabilities.⁵ The plan administrator initiates the termination by giving written notice to each affected party⁶ of the intent to terminate the plan between 60 and 90

¹ Defined benefit plans are those where participants are promised a specified future benefit, which traditionally is an annuity beginning at retirement. For defined benefit plans, the employer bears the investment risk and is responsible for any shortfalls. ERISA § 3(35); 29 U.S.C. § 1002(35).

² A defined contribution plan is a pension plan in which the contributions are specified, but not the benefits. A defined contribution plan provides an individual account for each participant that accrues benefits based solely on the amount contributed to the account and any income, expenses, and investment gains or losses to the account. See ERISA § 3(34); 29 U.S.C. § 1002(34).

³ ERISA § 4021(b); 29 U.S.C. § 1321(b).

⁴ For information on the PBGC's role with respect to multiemployer plans, see CRS Report R43305, *Multiemployer Defined Benefit (DB) Pension Plans: A Primer and Analysis of Policy Options*, by John J. Topoleski.

⁵ ERISA § 4041(b); 29 U.S.C. § 1341(b).

⁶ Affected parties include plan participants, beneficiaries (of deceased participants or alternate payees under a qualified domestic relations order), alternate payees under qualified domestic relations orders, employee organizations representing plan participants, and any person who has been designated to receive notice on behalf of an affected party. ERISA § 4001(a)(21); 29 U.S.C. § 1301(a)(21).

days in advance of the proposed termination date.⁷ He or she must then report information about the plan to the PBGC, including a certification by an enrolled actuary that the plan's assets are sufficient to meet all benefit liabilities.⁸ The plan administrator is also responsible for informing the plan participants and beneficiaries of the benefits due them, as well as information used in determining benefit liabilities.⁹

The PBGC's involvement in a standard termination is minimal, and its role is basically to confirm that the above requirements have been met. Upon receiving the plan information, the PBGC generally has 60 days to review it and either approve the termination or send out a notice of noncompliance.¹⁰ If the PBGC determines the requirements have been met, the termination proceeds. The plan administrator then distributes the plan's assets to participants and beneficiaries by purchasing annuities from a commercial insurer or by other permissible means.¹¹ If there are missing participants, the plan administrator may, after a diligent search, purchase an annuity for these individuals or transfer their distributions to the PBGC, which will hold them until the participants are found.¹² The plan administrator's final action is to certify to the PBGC that the assets have been distributed,¹³ and the plan is terminated.

Distress Termination

A distress termination occurs when a plan administrator seeks to terminate a plan that does not have sufficient assets to cover all the benefits owed to plan participants and beneficiaries.¹⁴ The plan may be terminated only if certain criteria are met, such as if its contributing sponsor, or a member of the sponsor's controlled group,¹⁵ (1) has filed (or has had filed against such person) a petition for liquidation or reorganization in bankruptcy or insolvency proceedings,¹⁶ and certain other requirements have been met, or (2) has demonstrated that termination is required to enable payment of debts while staying in business or to avoid unreasonably burdensome pension costs caused by a declining workforce.¹⁷

In order to initiate a distress termination, a plan administrator must give written notice of an intent to terminate the plan to each affected party, including the PBGC, at least 60 days and (except with PBGC approval) not more than 90 days before the proposed termination date.¹⁸ After

⁷ ERISA § 4041(a)(2); 29 U.S.C. § 1341(a)(2); 29 C.F.R. § 4041.23(a).

⁸ ERISA § 4041(b)(2)(A); 29 U.S.C. § 1341(b)(2)(A).

⁹ ERISA § 4041(b)(2)(B); 29 U.S.C. § 1341(b)(2)(B).

¹⁰ ERISA § 4041(b)(2)(C); 29 U.S.C. § 1341(b)(2)(C).

¹¹ ERISA § 4041(b)(3); 29 U.S.C. § 1341(b)(3).

¹² ERISA § 4050; 29 U.S.C. § 1350.

¹³ ERISA § 4041(b)(3)(B); 29 U.S.C. § 1341(b)(3)(B).

¹⁴ ERISA § 4041(c); 29 U.S.C. § 1341(c).

¹⁵ For purposes of the plan termination provisions, "'controlled group' means, in connection with any person, a group consisting of such person and all other persons under common control with such person," as determined under PBGC regulations. ERISA § 4001(a)(14); 29 U.S.C. § 1301(a)(14).

¹⁶ The Pension Protection Act of 2006 (P.L. 109-280, § 404) amended the law to require that certain determinations, including the calculation of the plan participants' guaranteed benefits, be made using the date the bankruptcy petition is filed, rather than the plan's actual termination date. ERISA §§ 4022(g), 4044(e); 29 U.S.C. §§ 1322(g), 1344(e). This affects both distress and involuntary terminations (discussed below), and one consequence is that post-bankruptcy accruals are no longer guaranteed.

¹⁷ ERISA § 4041(c)(2)(B); 29 U.S.C. § 1341(c)(2)(B).

¹⁸ ERISA § 4041(a)(2); 29 U.S.C. § 1341(a)(2); 29 C.F.R. § 4041.43(a).

the notice of intent is submitted to affected parties, the plan administrator must submit certain additional information to the PBGC, which may include a certification by an enrolled actuary regarding the amount of the current value of the assets of the plan, the actuarial present value of the benefit liabilities under the plan, and whether the plan is sufficient to pay benefit liabilities.¹⁹ Based on this information, the PBGC determines whether the distress termination criteria are met (or whether the PBGC is unable to make such a determination) and must notify the plan administrator of its finding as soon as practicable.²⁰

If the distress criteria have not been met, the plan continues to operate. If the criteria are met, the PBGC must then determine whether the plan's assets are sufficient to pay the benefits guaranteed by the PBGC and/or meet all benefit liabilities. These amounts may be different because, as mentioned, the benefits guaranteed by the PBGC under the plan insurance termination program are subject to statutory limitations; therefore, the benefit liabilities owed under the plan may exceed the benefits guaranteed by the PBGC. If the PBGC determines that the plan's assets are sufficient to pay benefit liabilities, a plan administrator must carry out termination of the plan under the procedures of a standard termination, and take additional action if necessary.²¹ Similarly, if the PBGC determines that a plan has sufficient assets to cover guaranteed benefits, but not benefit liabilities, the plan administrator will be required to distribute plan assets as with a standard termination, certify to the PBGC that the distribution has occurred, and take other actions as necessary to terminate the plan.²² If the plan's assets are not sufficient to pay the guaranteed benefits, the PBGC must commence involuntary termination proceedings (discussed below).²³ If the plan administrator discovers during the distribution that the plan's assets are not sufficient to cover benefits, he or she must notify the PBGC, which may then be required to initiate an involuntary termination.²⁴ If there are missing participants, the plan administrator may purchase an annuity for these individuals, or transfer their distributions to the PBGC after a diligent search.²⁵

Involuntary Termination

An involuntary termination occurs when the PBGC decides a plan should be terminated.²⁶ The PBGC must initiate termination proceedings once it determines a plan does not have assets available to pay benefits currently due. The PBGC may seek to terminate a plan if

- the plan has not met the minimum funding requirements or there has been notification from the Treasury Secretary that a notice of deficiency concerning the initial tax on a funding deficiency has been mailed;
- the plan will not be able to pay benefits when due;

¹⁹ ERISA § 4041(c)(2)(A); 29 U.S.C. § 1341(c)(2)(A). This additional information must be provided to other affected parties no later than 15 days after (1) the receipt of a request for the information or (2) the provision of new information to the PBGC relating to a previous request. ERISA § 4041(c)(2)(D); 29 U.S.C. § 1341(c)(2)(D).

²⁰ ERISA § 4041(c)(2)(C); 29 U.S.C. § 1341(c)(2)(C).

²¹ ERISA § 4041(c)(3)(B)(i); 29 U.S.C. § 1341(c)(3)(B)(i).

²² ERISA § 4041(c)(3)(B)(ii); 29 U.S.C. § 1341(c)(3)(B)(ii).

²³ ERISA § 4041(c)(3)(B)(iii); 29 U.S.C. § 1341(c)(3)(B)(iii).

²⁴ ERISA § 4041(c)(3)(C); 29 U.S.C. § 1341(c)(3)(C).

²⁵ ERISA § 4050; 29 U.S.C. § 1350.

²⁶ ERISA § 4042; 29 U.S.C. § 1342.

- a distribution of at least \$10,000 has been made to a participant who is a substantial owner of the sponsoring company and, immediately after the distribution, the plan has unfunded nonforfeitable benefits; or
- the long-run loss to the PBGC may reasonably be expected to increase unreasonably if the plan is not terminated.²⁷

A trustee, who may be the PBGC, may be appointed to administer the plan until it is ordered to be terminated.²⁸ The trustee may be appointed by a U.S. district court upon petition by the PBGC or plan administrator, or the PBGC and plan administrator may agree to the appointment without court involvement. Once appointed, the trustee is responsible for the plan's administration, including management of the plan's assets.²⁹

After the PBGC has given notice to the plan administrator, the plan may be terminated in one of two ways. First, the PBGC may file a petition with the U.S. district court for a ruling that the plan must be terminated to protect the participants' interests, to avoid an unreasonable deterioration of the plan's financial condition, or to avoid an unreasonable increase in the PBGC's liability.³⁰ If a trustee has been appointed, he or she may intervene in the proceeding. The PBGC may file the petition regardless of whether there is a pending proceeding (1) involving bankruptcy, mortgage foreclosure, or equity receivership; (2) to reorganize, conserve, or liquidate the plan or its property; or (3) to enforce a lien against the plan's property.³¹ Furthermore, the court may stay any pending proceedings that involve plan property.³² If the court agrees with the PBGC that the plan should be terminated, the court will then appoint a trustee, or authorize the existing trustee, to terminate the plan.

Alternatively, the PBGC and plan administrator may agree to terminate the plan without court proceedings.³³ There is no requirement under ERISA that plan participants and other interested parties receive notice or an opportunity to be heard prior to the PBGC and plan administrator coming to an agreement to terminate the plan.³⁴

Employer Liability

Standard Termination

In a standard termination, the plan sponsor has no further liability to the PBGC or plan participants. The plan sponsor may be able to recapture any assets remaining after participants have received their share, which is known as a "reversion." A reversion may be subject to an excise tax at a 20% rate, which is increased to 50% if the plan sponsor does not take certain actions, such as establishing a qualified replacement plan.³⁵

²⁷ ERISA § 4042(a); 29 U.S.C. § 1342(a).

²⁸ ERISA § 4042(b); 29 U.S.C. § 1342(b).

²⁹ ERISA § 4042(d); 29 U.S.C. § 1342(d).

³⁰ ERISA § 4042(c)(1); 29 U.S.C. § 1342(c)(1).

³¹ ERISA § 4042(e); 29 U.S.C. § 1342(e).

³² ERISA § 4042(f); 29 U.S.C. § 1342(f).

³³ ERISA § 4042(c)(1); 29 U.S.C. § 1342(c)(1).

³⁴ See *In Re Jones & Laughlin Hourly Pension Plan v. LTV Steel Co.*, 824 F.2d 197 (2^d Cir. 1987).

³⁵ 26 U.S.C. § 4980.

Distress and Involuntary Terminations

In a distress termination and an involuntary termination, the plan sponsor and members of its controlled group are jointly and severally liable to the PBGC for, among other things, the amount that the benefit liabilities exceed plan assets, with interest, at termination.³⁶ The PBGC will have a claim to recover at least some of these amounts. If successful, the PBGC will pay some of the recovery to plan participants as additional benefits and will keep the remaining amount to help cover its losses.

The employer's payment for the liability is due on the plan's termination date. The PBGC is authorized to make arrangements with the liable parties for the payments,³⁷ and any amount in excess of 30% of the collective net worth of the sponsor and controlled group will be paid under commercially reasonable terms.³⁸ In addition, the PBGC may claim a lien for up to 30% of the collective net worth of the sponsor and controlled group.³⁹ The PBGC may bring a civil action in U.S. district court to enforce the lien, which generally must be filed within six years of the plan's termination date. The lien has the same priority as a federal tax lien in Section 6323 of the Internal Revenue Code and is treated as a federal tax lien in bankruptcy proceedings.⁴⁰

Attempt to Evade Liability

If a company sells or transfers a business with an underfunded pension plan in order to evade liability and the plan is ended within five years of the sale or transfer, ERISA provides that the company can still be treated as a contributing sponsor at the plan's termination date.⁴¹ Thus, the company may be held liable for the unfunded liabilities.

Enforcement and Penalties

The PBGC is broadly authorized to make any investigation it deems necessary to enforce ERISA⁴² and may assess a penalty against anyone who fails to provide a required notice or other material information.⁴³ The penalty is limited to \$1,000 for each day the failure occurs.⁴⁴ In addition, plan participants, beneficiaries, fiduciaries, and sponsors who are adversely affected by an action of another (other than the PBGC) that violates the termination provisions may file suit in U.S. district court to enjoin the action or obtain other equitable relief.⁴⁵ Employee organizations representing affected participants and beneficiaries are also able to file a claim, and the PBGC has the right to intervene in any action.

³⁶ ERISA § 4062(b)(1); 29 U.S.C. § 1362(b)(1). In general, the sponsor and controlled group may also be liable to the trustee for certain specified funding shortfalls. ERISA § 4062(c); 29 U.S.C. § 1362(c).

³⁷ ERISA § 4067; 29 U.S.C. § 1367.

³⁸ ERISA § 4062(b)(2)(B); 29 U.S.C. § 1362(b)(2)(B).

³⁹ ERISA § 4068; 29 U.S.C. § 1368.

⁴⁰ ERISA § 4068(c); 29 U.S.C. § 1368(c).

⁴¹ ERISA § 4069; 29 U.S.C. § 1369.

⁴² ERISA § 4003(a); 29 U.S.C. § 1303(a).

⁴³ ERISA § 4071; 29 U.S.C. § 1371.

⁴⁴ *Id.*

⁴⁵ ERISA § 4070; 29 U.S.C. § 1370.

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