



For your information®

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## Slim chance for PBGC coverage of shutdown benefits under final rule

Final PBGC regulations tightly limit the shutdown and other “unpredictable contingent event benefits” that are eligible for PBGC’s guarantees when a single-employer plan undergoes a distress or involuntary termination. The regulations implement a PPA provision, effective for events that occur after July 26, 2005, that sets the date the event triggering the benefit occurs as the earliest date the phase-in period can begin for these types of benefits. Plan administrators have a responsibility to reflect this change when paying benefits beginning on a plan’s proposed termination date.

### Background

Under the private-sector, single-employer defined benefit PBGC insurance program, participant pension expectations are insured up to a maximum guaranteed benefit level when a plan is terminated either in a distress termination or in an involuntary termination (one initiated by PBGC). New plans and plan improvements are not guaranteed in full until the plan, or improvement, has been in effect for at least five years (10 years for certain substantial owners). Under the five year phase-in, an additional 20% of a participant’s benefit becomes insured with each year completed after the later of the adoption or effective date applicable to the benefit. This “phase-in” protects the PBGC from having to insure benefits adopted in contemplation of the plan’s termination and to allow time for some funding of new liabilities before they are fully guaranteed.



Prior to the Pension Protection Act of 2006 (PPA), PBGC treated a plan provision providing for unpredictable contingent event benefits (UCEBs) — benefits resulting from an unpredictable contingent event (UCE)— as being adopted when the provision was first included in the plan (as opposed to when the event occurred). Thus, if the UCEB provision was included in the original plan, and the date of plan termination was more than five years later, the PBGC guarantee would cover the UCEB even if the UCE occurred the day before the plan termination.

PPA changed the phase-in rule for UCEBs by treating the date the UCE occurs as the date of amendment. The result is that there is no PBGC coverage at all for a UCEB triggered within a year of the plan’s termination, and less than full coverage for those triggered within the five years leading up to the termination of the plan.

**Buck comment.** Keep in mind too that the IRC 436 benefit restriction rules can prevent a plan from paying UCEBs if the plan’s funding rate drops below 60%.

## PBGC adopts final rule

The [final regulations](#) adopted by PBGC to fully implement the PPA provision are nearly the same as their 2011 proposed regulation (see our [March 29, 2011 For Your Information](#) for details and further commentary). A quick recap follows.

### ***What's a UCEB?***

A UCEB is an additional benefit that the plan pays only if a UCE occurs (rather than because of age or service). For example, a shutdown, which is one of the most common forms of UCEs, frequently allows a participant to retire early without a reduction in benefits (the UCEB is the reduction that is not imposed). The triggering “shutdown” could be the closing of a plant or a line of business, or a layoff.

Despite the use of “unpredictable” in its name, a UCEB is not defined in terms of a degree of predictability, but rather is defined as a benefit that is “payable solely by reason of a shutdown or similar event ... or an event other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or occurrence of death or disability.” Thus, PBGC says a benefit does not cease to be a UCEB for phase-in purposes merely because the UCE has already occurred or its occurrence has become reasonably predictable.

### ***When does the phase-in start?***

The phase-in of the PBGC guarantee of a UCEB occurs at the latest of three dates:

- The adoption date of the plan provision that provides for the UCEB
- The effective date of the UCEB
- The date the UCE occurs for the individual

**Buck comment.** The PBGC added the adoption date of the UCEB plan provision to address the unlikely situation of a retroactive adoption of a plan provision providing UCEBs.

### ***When does the phase-in end?***

There's nothing new here — it ends on the plan termination date. But another PPA change is worth mentioning — the bankruptcy rule for terminating plans. See our [June 29, 2011 For Your Information](#). Under PPA, when an underfunded plan terminates while its contributing sponsor is in bankruptcy, the sponsor's bankruptcy filing date is treated as the plan termination date for determining the phase-in of guaranteed benefits. Thus a condition highly likely to trigger a UCEB is also a condition that cuts short any possible guarantee.

### ***Some UCEBs survive***

For UCEBs triggered at least three years prior to plan termination (or bankruptcy), payment of the benefit is possible from an underfunded plan even though it is not fully guaranteed. This result follows from the mechanics of the “4044 allocation” of plan assets upon the termination of the plan. A benefit increase that had been adopted at least five years before the plan termination date can be allocated to priority category 3 and have a better chance of being covered by available plan assets. This will be the case for a benefit that had been in pay status (or would have been had the participant retired) at least three years before the plan termination date. The PBGC confirmed this result by noting that the PPA change for UCEBs did not make any reference to section 4044.

***Change from proposed rule — who decides?***

One change was made in response to the single public comment objecting to the level of deference granted PBGC for evaluating “facts and circumstances” that are considered in determining the date when a UCE occurs. The commenter asked that PBGC be required to defer to the determinations made by plan administrators and arbitrators, and by judicial decisions about collective bargaining agreements. In response, PBGC’s final regulation specifically includes determinations and statements by plan representatives, arbitrators, and courts as factors that will be considered, to the extent relevant, in establishing the UCE date. PBGC will not, however, treat any such determinations or statements as controlling.

**Buck comment.** The fact that a plan administrator’s determination is not controlling does not mean that plan administrators can ignore creating and maintaining records about the additional benefits provided when UCEs occur. Administrators of plans undergoing a distress termination are required by ERISA to limit payment of benefits to estimated guaranteed benefits and estimated nonguaranteed benefits funded through the section 4044 allocation beginning on the proposed termination date. This determination will need to consider the date the UCE occurs under the final regulation.

**In closing**

The final regulation, effective June 5, 2014, will apply to UCEBs that become payable as a result of a UCE that occurs after July 26, 2005. Plan administrators of plans in poor financial condition with plan sponsors facing financial woes of their own need to be diligent about monitoring potential benefit cutbacks that may become necessary under a distress or involuntary termination. This is particularly the case for benefit enhancements triggered by UCEs that will need to be discontinued, perhaps before they can even be started.

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