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CRS Report for Congress

Pension Protection Act of 2006: Summary of the PBGC Guarantee and Related Provisions

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Summary

Title IV of the Pension Protection Act of 2006 (P.L. 109-280; August 17, 2006) contains several provisions concerning premiums and benefit guarantees under the Pension Benefit Guaranty Corporation's (PBGC's) insurance program. The Title also contains special funding rules for commercial airlines and airline catering companies. Other provisions address issues such as rules for substantial owners, the appointment of the PBGC director, and missing participants. This report summarizes the Title's provisions. For additional information on the Pension Protection Act, see CRS Report RL33703, *Summary of the Pension Protection Act of 2006*, by Patrick Purcell.

The Pension Benefit Guaranty Corporation (PBGC), established in 1974 by the Employee Retirement Income Security Act of 1974 (ERISA) (P.L. 93-406) provides insurance protection for participants and beneficiaries of private sector defined benefit plans. The PBGC guarantees certain benefits, up to a maximum limit, should a plan terminate with a lack of sufficient assets to pay promised benefits. Currently, the PBGC pays monthly retirement benefits to about 683,000 retirees in 3,595 terminated pension plans.[1] This report summarizes Title IV of the Pension Protection Act of 2006 (the Act), which contains provisions affecting the PBGC.

Variable Rate and Termination Premiums. Defined benefit plans are required to pay annual premiums to the PBGC. The PBGC is solely funded by these premiums and investment returns on the assets held in its trust fund. It receives no appropriations from Congress.

Single-employer plans must pay a flat-rate premium. In 2007, this premium is $31.00 per participant. Future flat-rate premiums will be adjusted each year for inflation,

[1] *See*, "How PBGC Operates," *available at* [http://www.pbgc.gov/about/operation.html].

based on changes in the national average wage index.[2] Underfunded single-employer plans (i.e., plans that contain "unfunded vested benefits," in which the amount of the plan's benefit liabilities exceeds the plan's assets) must also pay a variable rate premium. This variable rate premium rate is $9.00 per $1,000 of unfunded vested benefits.

Section 401 of the Act sets out a new way in which to determine the amount of unfunded vested benefits for purposes of calculating the variable rate premium.[3] Under this rule, which only applies to single-employer plans, the determination of "unfunded vested benefits" conforms to the new plan funding rules set out in other sections of the Act. This section defines "unfunded vested benefits" to mean the excess (if any) of (1) the funding target of the plan as determined under ERISA § 303(d), by only taking into account vested benefits and using an interest rate specified in section 401, over (2) the market value of plan assets for the plan year that are held by the plan on the valuation date.[4] Section 401(a) is effective beginning in 2008.

Section 401(b) makes permanent a termination premium created by the Deficit Reduction Act of 2005. This rule imposes a fee of $1,250 per participant on bankrupt employers that terminate their pension plans and turn their pensions over to the Pension Benefit Guaranty Corporation. This fee applies for three years after plan termination.

The Pension Protection Act of 2006 also changes the variable rate premium for small employers (i.e., employers with 25 or fewer employees). Under section 405 of the Act, variable rate premiums for small employers cannot exceed $5 multiplied by the number of participants in the plan at the close of the preceding plan year.[5] The section also contains a method by which it can be determined whether an employer has 25 or fewer employees. Section 405 is effective for plan years beginning on January 1, 2007.

Special Funding Rules for Plans Maintained by Commercial Airlines. Single-employer defined benefit plans are typically subject to minimum funding requirements set out in ERISA and the Internal Revenue Code. Under section 402 of the Act, a defined benefit plan maintained by a commercial airline or an airline catering service is exempt from these funding rules.[6] Plan sponsors may elect to amortize unfunded liabilities over a period of 10 years (as opposed to 7 years under the normal funding requirements) or may instead follow special rules that permit these plan sponsors to amortize unfunded liabilities over 17 years.

Section 402 also contains several requirements for plan sponsors who select the 17-year amortization period, referred to by the Act as an "alternative funding schedule." Under section 402(b), plan sponsors who elect an alternative funding schedule must comply with certain benefit accrual requirements, which include freezing some of the benefits offered under the plan and eliminating others. Additional requirements include

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[2] See ERISA § 4006(a)(3)(F); 29 U.S.C. §1306(a)(3)(F).

[3] ERISA § 4006(a); 29 U.S.C.§ 1306(a).

[4] ERISA § 4006(a)(3)(E)(iii); 29 U.S.C.§ 1306(a)(3)(E)(iii).

[5] *Id.*

[6] 26 U.S.C. § 430 nt.

election procedures for the alternative funding schedule,[7] minimum contribution requirements, and participant notice. Special rules for plan spinoffs and plan terminations may also apply. The provisions of section 402 are effective for plan years ending after the date of the enactment of the Act (August 17, 2006).

Limitation on Reduction in PBGC Guarantee for Shutdown and Other Benefits. A defined benefit plan may include benefits that are payable based only on the occurrence of a unpredictable event, such as a facility shutdown or a workforce reduction. The PBGC guarantees these "unpredictable contingent event benefits" subject to certain limitations. Under section 403 of the Act, PBGC guarantees for contingent event benefits are to be calculated using the same method as benefits associated with plan amendments that are made within five years of the date of termination.[8] The formula to be used is the greater of (a) 20% of the guaranteed benefit or (b) $20 per month, multiplied by the number of years since the date the unpredictable contingent event occurred (not to exceed five years).[9] Section 403 applies to unpredictable contingent event benefits that become payable as a result of an event that occurred after July 26, 2005.

Guaranteed Benefits and Employer Bankruptcy. When an employer terminates an underfunded plan, the PBGC will guarantee a certain amount of benefits as of the date of termination. Under section 404 of the Act, the amount of PBGC guaranteed benefits is frozen when an employer enters bankruptcy or a similar proceeding.[10] If a plan terminates during the employer's bankruptcy, the amount of guaranteed benefits will depend on the benefits available on the date the employer entered bankruptcy.[11] Section 404 applies with respect to bankruptcy proceedings or other similar proceedings initiated on or after September 16, 2006.

Interest on Premium Overpayments to the PBGC. As discussed above, defined benefit plans sponsored by employers in the private sector are required to make premium payments to the PBGC. If any premium payment is considered late, the PBGC is to impose interest charges on the unpaid amount. Under section 406 of the Act, the PBGC is now authorized to pay interest on the amount of any premium overpayment refunds.[12] This authority can be regulated by the PBGC. Also, interest paid by the PBGC on overpayments must be calculated in the same rate and manner as the interest calculated on premium underpayments. Section 406 applies to interest accruing for periods beginning on or after the date of enactment of the Act (August 17, 2006).

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[7] See Internal Revenue Service Announcement 2006-70 (Sept. 14, 2006) for additional guidance on the election of the alternative funding schedule.

[8] ERISA § 4022(b); 29 U.S.C. § 1322(b).

[9] ERISA § 4022(b)(7); 29 U.S.C. § 1322(b)(7).

[10] JOINT COMM. ON TAXATION, 109TH CONG, 2D SESS. TECHNICAL EXPLANATION OF H.R. 4, THE 'PENSION PROTECTION ACT OF 2006,' AS PASSED IN THE HOUSE ON JULY 28, 2006 AND AS CONSIDERED BY THE SENATE ON AUGUST 3, 2006, JCX-38-06, 79 (Comm. Print 2006). See also ERISA § 4022(g); 29 U.S.C. § 1322(g).

[11] *Id.*

[12] ERISA § 4007(b)(2); 29 U.S.C. § 1307(b)(2).

Substantial Owner Benefits. Special rules apply to plan participants who are "substantial owners" — individuals who own an entire interest in an unincorporated trade or business, more than 10% of the capital or profits interest in a partnership, or more than 10% of the voting stock or 100% of all the stock of a corporation. Section 407 changes two of these rules. First, under one of these rules as it existed prior to the Act, the maximum benefit guaranteed by the PBGC for substantial owners was phased in over a 30-year period. Specifically, the maximum benefit was determined by dividing the number of years the owner participated in the plan by 30. This number or one, whichever was lesser, was then multiplied by the monthly guaranteed benefit determined without the special rule. If the plan had been amended to increase benefits, each amendment was treated as a new plan and subject to the calculation.

Section 407 of the Act amends this rule in two ways.[13] First, it makes the rule apply to majority owners rather than substantial owners. A *majority owner* is an individual who owns the entire interest in an unincorporated trade or business, at least 50% of the capital or profits interest in a partnership, or at least 50% of the voting stock or 100% of all the stock of a corporation. A *substantial owner* who is not a majority owner is no longer subject to the special rule regarding maximum guaranteed benefits. Second, the section changes the formula for determining the maximum guaranteed benefit. Under the new formula, the majority owner's maximum guaranteed benefit is phased in over a 10-year period. Specifically, it is determined by dividing the number of years between the plan's effective or adoption date (whichever is later) and the plan's termination date by 10. This number or one, whichever is lesser, is multiplied by the amount of benefits that would have been guaranteed had the participant not been a majority owner.

Another special pre-Act rule that applied to substantial owners related to the allocation of plan assets at termination. ERISA creates six categories of benefits to prioritize how plan assets will be distributed when the plan terminates. The fourth category includes all guaranteed benefits not allocated to higher categories and, prior to the Act, the benefits of substantial owners that exceeded the maximum guaranteed benefit as determined under the special rule discussed above. Under section 407 of the Act, this rule applies to majority owners rather than substantial owners.[14] The Act also provides that, for purposes of the fourth category, assets are first allocated to the guaranteed benefits and then to the majority owners' benefits.[15]

Section 407 generally applies to distress and involuntary terminations for which notices of intent to terminate or determination are provided after December 31, 2005.

Benefits Attributable to Recoveries from Employers. The sponsor of a terminating plan and the members of its controlled group are liable for amounts including unfunded benefit liabilities and unpaid employer contributions. The PBGC is to attempt to recover these amounts and pay a portion of them to plan participants as additional benefits (i.e., benefits in addition to the amounts guaranteed by the PBGC). The PBGC would keep the rest to reduce its losses.

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[13] ERISA § 4022(b)(5); 29 U.S.C. § 1322(b)(5).

[14] ERISA § 4044(a)(4); 29 U.S.C. § 1344(a)(4).

[15] ERISA § 4044(b); 29 U.S.C. § 1344(b).

With respect to unfunded benefit liabilities, the plan participants' share is the amount of the non-guaranteed and non-allocated benefit liabilities multiplied by a recovery ratio. For large plans whose outstanding benefit liabilities exceed $20 million, the recovery ratio is the amount recovered from the plan over the plan's unfunded benefit liabilities on the termination date. For all other plans, the recovery ratio is not based on the amount actually recovered from the plan, but rather on the PBGC's recoveries from all plan terminations that occurred during a specified period. Specifically, the recovery ratio is the amount recovered from plans terminating during the specified period over the total amount of those plan's unfunded benefit liabilities on their termination dates. Under the law prior to the Act, the specified period was the five-federal fiscal year period that ended with the year immediately prior to the year in which the appropriate termination notice was given for the plan for which the recovery ratio was being determined. Under section 408 of the Act, the specified period is changed to the five-federal fiscal year period ending with the third year preceding the year in which that notice is given.[16]

With respect to unpaid employer contributions, the amount that went to the plan participants prior to the Act was based on the amount recovered from that plan. Section 408 of the Act creates a new formula that is similar to that used for unfunded benefit liabilities. Under the section, the plan participants' share is determined by multiplying the amount of the liability by a recovery ratio.[17] For large plans, the recovery ratio is the actual recovery from the plan over the total liability. For other plans, the recovery ratio is the amount recovered for these unpaid contributions from plans that terminated during the specified period over those plans' total such liability at their termination dates. The specified period is the five-federal fiscal year period that ended with the third year immediately prior to the year in which the appropriate termination notice was given for the plan for which the recovery ratio is being determined. The determinations made by the PBGC for these rules are binding unless shown by clear and convincing evidence to be unreasonable.

Section 408 applies to terminations for which notices of intent to terminate or of determination are provided on or after the date which is 30 days after August 17, 2006.

Cessation or Change in Membership of a Controlled Group. A plan administrator may terminate its single-employer plan if the plan's assets exceed its benefit liabilities. The PBGC may terminate a single-employer plan if the PBGC's possible long-run loss may be expected to unreasonably increase if the plan continues. In both situations, the plan's benefit liabilities are determined by calculating the present value of the benefits owed under the plan using the PBGC's interest and mortality assumptions. Section 409 of the Act provides that, in certain situations, the interest rate used to calculate the plan's benefit liabilities can not be less than the interest rate used to determine whether the plan is fully funded.[18] The rule applies if there is a transaction (or series of transactions) that results in a person no longer being a member of a controlled group and that person immediately before the transaction maintained a fully funded

[16] ERISA § 4022(c)(3)(B)(ii); 29 U.S.C. § 1322(c)(3)(B)(ii).

[17] ERISA § 4044(e); 29 U.S.C. § 1344(e) [it appears this should be changed to ERISA § 4044(f) and 29 U.S.C. § 1344(f)].

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

single-employer defined benefit plan. The employer maintaining the plan before or after the transaction must meet requirements pertaining to creditworthiness, and the employer maintaining the plan after the transaction must continue to employ at least 20% of its U.S. workforce. The special interest rate rule does not apply if the plan is terminated after the close of the two-year period beginning on the date of the initial transaction. The section applies to any transaction (or series of transactions) occurring on or after August 17, 2006.

Missing Participants. In general, when a single-employer plan terminates under a standard termination, the plan administrator must purchase annuity contracts from a private insurer to provide the benefits owed to the plan participants and then distribute them to the participants. In the event that the plan administrator is unable to locate a plan participant after a diligent search, he or she may either purchase an annuity from an insurer or transfer the missing participant's benefits to the PBGC. Section 410 of the Act requires the PBGC to prescribe similar regulations for terminating multiemployer plans.[19] It also allows certain single-employer plans that were not previously covered by the missing person rule to transfer missing participants' benefits to the PBGC according to regulations promulgated by the PBGC.[20] The section applies to distributions made after the regulations are finalized.

PBGC Director. Section 411 creates a new director position to administer the PBGC.[21] The PBGC director is to be appointed by the President, with the advice and consent of the Senate.[22] The Senate Committee on Finance and Committee on Health, Education, Labor, and Pensions have jurisdiction over the nomination. If one committee votes to order the nomination reported, the other must act within 30 calendar days or the nomination is automatically discharged. The section also establishes the director's compensation at Level III of the Executive Schedule.[23] Finally, the section provides transition rules regarding the interim director.

PBGC Annual Report. The PBGC must issue an annual financial report to the President and Congress that includes information on its finances and operations and an actuarial five-year projection of its revolving funds. Section 412 of the Act requires additional information be included in the annual report, specifically (1) information on the Pension Insurance Modeling System microsimulation model, (2) a comparison of the investment return earned by the PBGC for the year with an investment return based on the average for the S&P 500 and the Lehman Aggregate Bond Index (or similar index), and (3) a statement on what the PBGC's deficit or surplus would have been for the year had it earned the latter rate of return.[24]

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[19] ERISA § 4050(c); 29 U.S.C. § 1350(c).

[20] ERISA § 4050(d); 29 U.S.C. § 1350(d).

[21] ERISA § 4002(a); 29 U.S.C. § 1302(a).

[22] P.L. 109-280, § 411(c).

[23] 5 U.S.C. § 5314.

[24] ERISA § 4008(b); 29 U.S.C. § 1308(b).