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Changes Afoot for ERISA "Reportable Event" Rules

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As many as 90% of pension plans and pension plan sponsors may soon have fewer "reportable events" to track and report to the Pension Benefit Guaranty Corporation (the "PBGC"), if certain proposed changes to the PBGC regulations are finalized this summer. These proposed changes were published by the PBGC on April 3, 2013.

The PBGC is a wholly owned United States government corporation and an agency of the United States that administers the private-sector defined benefit pension plan termination insurance program under Title IV of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). In fulfilling these obligations, the PBGC monitors the status of such pension plans to pick up on early alerts of adverse changes in the plan or the plan sponsor that would enable it to mitigate such changes. As part of this monitoring, ERISA requires plan sponsors to inform the PBGC when certain "reportable events" occur. The PBGC's current regulations explaining these reportable event requirements include a variety of waivers and extensions that allow plan sponsors to delay or avoid reporting of certain events, if a plan's funding is maintained at a specified level (referred to as funding-based waivers). The PBGC is now in the process of revising these regulations in an effort to shift the focus from a plan's funding to a plan sponsor's financial health when determining whether or not these reports must be submitted. The revisions would also expand existing waivers for small plans, modify the current foreign-entity and de minimis waivers, and eliminate certain other waivers now available to plans and their sponsors.

Reportable events under ERISA include (but are not limited to) the following: a reduction in active participants in a plan (currently, in general, when the number of active participants in a plan falls below 80% of the number of participants at the beginning of the year or below 75% of the number at the beginning of the prior year); the failure to make any required plan contributions when due; distributions to a substantial owner (currently, in general, if such distributions exceed $10,000); a change in the controlled group (namely, when a transaction results in one or more persons ceasing to be a member of a plan's controlled group); liquidation of a member of the plan's controlled group; the distribution of an extraordinary dividend; a transfer of 3% or more of a plan's benefit liabilities outside the controlled group; the default on a loan with an outstanding balance of $10 million or more; or bankruptcy or insolvency of a member of the plan's controlled group.

Under the revised regulations, reporting would be waived for most events covered by the funding-based waivers currently in existence under the regulations if a plan or its sponsor falls under one of two financial soundness safe harbors. A plan will qualify for the safe harbor if it is (a) fully funded on a termination basis on the last day of the plan year preceding the event year or (b) 120% funded on a premium basis for the plan year preceding the event year. In the alternative, a plan sponsor will qualify for the safe harbor if all of the following five criteria are met: (1) the credit report of the plan sponsor reflects a credit score indicating a low likelihood that the sponsor will default on its obligations; (2) the sponsor's secured debt is limited to that incurred in connection with the acquisition or improvement of property and is secured only by that property; (3) the sponsor has had a positive net income under generally accepted accounting standards (GAAP) or International Financial Reporting Standards (IFRS) for the past two years; (4) the sponsor has not met the criteria for an event of default with respect to a loan with an outstanding balance of $10 million or more for the past two years; and (5) the sponsor has made all of its pension contributions for the past two years, other than quarterly contributions for which reporting is waived. If the plan sponsor is part of a controlled group, the plan sponsor financial soundness criteria would be applied to the highest level United States company in the plan sponsor's chain of ownership.

If the regulations are revised as proposed, plans and plan sponsors that qualify for one of the two safe harbors will generally no longer need to track and report five reportable events: an active participant reduction (except in three specified situations), distributions to a substantial owner, a controlled group change, extraordinary dividends, or a transfer of benefit liabilities. Under the existing rules, a funding-based waiver applies to all of these reportable events. Funding-based waivers also apply, under the existing rules, to liquidation and loan default reportable events, which are discussed in the following paragraph. Regardless of whether a small plan (generally a plan with fewer than 100 participants at the end of the second preceding plan year) qualifies for the safe harbors, it will not be required to report an active participant reduction, a controlled group change, extraordinary dividends, a transfer of benefit liabilities or a missed quarterly contribution.

Under the current rules, the liquidation reportable event is waived where the entity or entities involved in the event are foreign entities (other than a parent of the contributing sponsor) or represent a de minimis percentage of the relevant controlled group. Both types of waiver also currently apply to controlled group change and extraordinary dividend reportable events. The foreign entity waiver also currently applies to loan default and bankruptcy/insolvency reportable events. The proposed new rules would preserve all five of these foreign entity waivers. The de minimis percentage waiver would likewise apply to all five of these reportable events under the proposed new rules, thereby expanding the de minimis waiver to two new reportable events—loan default and insolvency. Note also that under the proposed new rules, bankruptcy under the Bankruptcy Code would no longer be a reportable event.

Private-sector bank credit agreements and other financing agreements typically require the borrower or other obligor to notify the lender of certain events that may adversely affect, or be indicative of an adverse change in, the borrower's credit status. Included among these reporting covenants is typically an undertaking of the borrower to report to the lender the occurrence of an ERISA reportable event with respect to any pension plan sponsored by the borrower or any member of its controlled group. An ERISA reportable event is typically also an event of default, but typically subject to some sort of materiality threshold, such as the occurrence of a reportable event that is reasonably expected to result in a material adverse effect for the borrower. Financing agreements also typically require the borrower to make representations about ERISA reportable events. It is common for a financing agreement to exempt from these consequences any, or certain, reportable events that are waived by the PBGC regulations. It remains to be seen how this market practice will be affected by the expanded PBGC waivers. Bank lenders may conclude that they have an interest in knowing about some of the newly waived reportable events, if the new rules take effect. In that case, borrowers may push back since this would require them to monitor the occurrence of ERISA reportable events that they would otherwise have no obligation to monitor under the PBGC regulations.

The PBGC will be holding regulatory hearings in June 2013 in the hopes of finalizing the revised regulations for implementation in 2014.

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Mark Hamilton *counsels clients on employee benefits and compensation matters, including those arising in mergers and acquisitions, financing arrangements and other types of corporate transactions. He provides counsel regarding stock-based compensation arrangements, employment agreements, change-in-control agreements and all other executive compensation arrangements. His practice includes tax matters, such as Code Section 280G golden parachute issues, performance-based compensation compliance under Code Section 162(m) and the design of deferred compensation plans.*

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