

Compliance Advisory

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PBGC Provides Guidance on Liability for Facility Closing

The Pension Benefit Guaranty Corporation (PBGC) requires sponsors of qualified defined benefit plans to report certain events and corporate transactions. These “reportable events” are important because they may impact a plan’s ability to pay benefits or affect a plan termination. One reportable event occurs when an employer ceases operations at a facility in any location and, as a result, more than 20% of the employees who are participants in a defined benefit plan lose their jobs. Plan sponsors must notify the PBGC of this reportable event within 60 days after it occurs.

Recently, the PBGC published guidance that provides a formula to calculate the liability that arises when this event occurs. The guidance sets forth a formula which the PBGC formerly had been using on a case-by-case basis. This guidance applies to events occurring on or after July 17, 2006. Previously, the PBGC liability rules described situations in a multiple employer situation. However, these new rules apply to a single employer situation.

Under the PBGC guidance, the employer’s liability is a percentage of the plan’s unfunded benefit liabilities determined immediately after the date the facility closed. The total liability is multiplied by a fraction where (1) the numerator is the number of employees who were active participants in the plan and lost their jobs as a result of the facility closing and (2) the denominator is the total number of employees who were participants in the plan before the facility closed. The denominator does not include retirees and other former employees who separated from employment before the operations ceased.

For example: Company X sponsors a pension plan with 50,000 participants of whom 20,000 are current employees and 30,000 are retirees or deferred vested participants. On a PBGC termination basis, the plan is underfunded by \$80 million. Company X ceases operations at a facility causing 5,000 employees, all of whom are participants in the pension plan, to lose their jobs. To calculate Company X’s liability, the numerator is 5,000 and the denominator is 20,000. Therefore the amount of liability is \$20 million ($5,000/20,000 \times \80 million).

Usually, this amount is placed into an interest-bearing escrow account for the benefit of the plan. If the plan terminates within five years of the facility closing, the amount in the escrow account, including interest, is treated as a plan asset and is used to satisfy the plan’s termination liabilities. If the plan does not terminate within that time, the entire escrow amount is turned over to the employer. Alternatively, the PBGC may require the plan sponsor to furnish a bond to be held by the PBGC for the benefit of the plan for the same five-year period.

The PBGC has not provided guidance regarding what constitutes a cessation of operations. For example, the PBGC has not indicated whether a sale of assets may be treated as a plant closing or what is meant by a “facility in any location.” As a result, until the PBGC issues additional guidance, it will resolve these issues on a case-by-case basis. In addition, there is currently no limit on the amount of the liability determined in these situations. Finally, there is no exception to these rules for small plans (i.e., those plans with fewer than 500 participants).

Plan sponsors should refer any questions regarding the information contained in this publication to the plan’s enrolled actuary. Prudential Retirement’s enrolled actuaries are well prepared to discuss this guidance along with any other regulatory issues that you may have.

Compliance Advisory by Prudential Retirement

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