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PBGC Staff Object to Premium Savings in Spinoff and Termination Pension Annuity Transactions

PBGC staff have taken the position in informal guidance that plan sponsors that structure pension annuity purchases through spinoff and termination transactions should not be able to achieve the significant savings on PBGC premiums that may otherwise result from a straightforward application of PBGC regulations.

Spinoff and Termination Annuity Transactions

Generally, pension plans can transfer liabilities to insurance companies by purchasing annuities covering groups of participants and distributing the annuity contracts to those participants. For example, a plan may purchase annuity contracts for all retirees in pay status whose monthly benefit is less than a certain amount, such as $500 per month. In this case, not only does the plan transfer their liabilities to an insurance company, but PBGC premiums will not take into account these benefits in the future because they are no longer insured by the PBGC following distribution.

While this type of annuity purchase is entirely consistent with ERISA, PBGC staff, through a posting on the PBGC website, have recognized that some plan sponsors have considered structuring annuity transactions to achieve PBGC premium savings well beyond those that should result from the substance of the transaction through a two-step process, which the PBGC staff describe as follows:

(1) most plan participants are spun off late in the year into a new plan that is virtually identical to the old plan, but with a new name, EIN, and plan number, leaving only a small group of retirees in the original plan and

(2) what's left of the original plan is terminated (i.e., annuities are purchased for the remaining retirees).

Under a strict application of PBGC premium regulations, these transactions can result in substantial savings by taking advantage of rules under which (i) variable rate premiums (VRPs) do not apply in the year in which a pension plan makes a final distribution of assets following a standard termination and (ii) flat rate premiums are prorated for a short plan year of a new plan resulting from a mid-year spinoff transaction or a plan that has a final distribution of assets before the end of a plan year.

Views of PBGC Staff

PBGC staff indicated that based on a "substance over form" analysis, these two-step transactions (and any similar transactions) "should be disregarded and premiums assessed as if such transaction had not occurred."

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The reason the PBGC does not assess VRPs to a terminating plan is that VRPs are effectively a risk surcharge that apply only when a plan is underfunded, and it “did not seem appropriate” to assess a VRP when a plan was fully funded and terminated by the time the VRPs would otherwise be due because the PBGC does not have any potential liability for the plan. However, with a spinoff and termination transaction, the PBGC still retains the risk of liability for the vast majority of participants whose benefits are not being annuitized so the rationale for not charging VRPs does not hold. Further, PBGC staff believe that this type of transaction is particularly susceptible to abuse because plan sponsors could potentially engage in similar transactions year after year.

Implications

While the website posting suggests PBGC has the right to assess premiums as if spinoff and termination transactions had not occurred, it does not announce any plan to take premium enforcement actions against any plans that have already completed similar transactions. (The posting says PGBC staff are aware that some plan sponsors “are considering” these transactions; it does not recognize that any such transactions have already been completed.) If the PBGC were to assess additional premiums for completed transactions, it would face substantial hurdles. PBGC staff do not cite any particular precedents that would support the PBGC’s disregarding its own premium regulations to assess additional premiums and the website notes that PBGC staff’s views are “not rules, regulations, or statements of the [PBGC].” Further, any completed spinoff and termination transactions have already been subject to a 60-day PBGC review period applicable to standard terminations, which would make it more difficult for the PBGC to challenge the substance of the transaction after a transaction closed.

However, PBGC staff’s opinion on those transactions brings their viability into question because the PBGC may have the ability to hinder or prevent future transactions from occurring. Spinoff and termination transactions generally must be carefully timed and executed to achieve the anticipated premium savings by having a binding commitment from one or more insurance companies to provide annuity contracts before the end of a year. If the annuity purchase is not completed before the end of the year, then the spinoff transaction by itself can actually result in significant additional PBGC premiums as participants may be double-counted for flat-rate premium purposes as part of both the original plan and the new plan created by the spinoff transaction. The PBGC could use its 60-day review period, which may be extended, to challenge or delay the standard termination or to negotiate other concessions from plan sponsors.

In view of the PBGC staff’s views, plan sponsors should be aware that PBGC premium savings from structuring annuity purchases as spinoff and termination transactions may not be materialized.