Final Regulations Will Affect Default Risk for Borrowers with Pension Plans

By Peter J. Hunt and Jessica Lutrin

The Pension Benefit Guaranty Corporation (the PBGC) has adopted final regulations relieving certain sponsors of defined benefit pension plans from the obligation to report certain events that signal an increase in the plan's financial risk. The final regulations also revise many existing reportable event waivers. In recognition of the significant effect that pension liabilities can have on creditworthiness, many credit agreements refer to unwaived reportable events when defining the events of default.

On September 10, 2015, the PBGC released its long-awaited final regulations relating to reportable events under Section 4043 of the Employee Retirement Income Security Act (ERISA). The final regulations, among other changes, expand certain reporting waivers and revise certain reportable events.

The final regulations are intended to limit reporting to plan sponsors and pension plans presenting the most substantial risk of involuntary or distress termination and reduce the burden on a plan sponsor of determining when a reportable event occurs. The PBGC anticipates that approximately 94 percent of plan sponsors and pension plans will be exempt from many reporting requirements.

The following is an overview of the key changes to the reportable event requirements and a discussion of how these changes will impact the rights and obligations of parties to credit agreements and transaction agreements.

ERISA Reportable Events

ERISA requires sponsors of single-employer defined benefit pension plans to report certain events to the PBGC that could herald an increase in a plan's financial liabilities or a decrease in the plan sponsor's financial health. This mechanism allows the PBGC to identify pension plans that may terminate in distress or otherwise require the PBGC's financial assistance. Reportable events vary widely in their scope and include, among others, a change in the identity of a plan sponsor or change in composition of the sponsor's controlled group and the transfer of plan liabilities to a plan sponsored by a company outside the transferring sponsor's controlled group.

Unless a waiver or extension applies, reports to the PBGC are due 30 days after the event occurs (known as post-event reporting). However, for some privately-held companies with large underfunding, reports to the PBGC are due 30 days in advance of the occurrence of certain events (known as advance reporting). The final regulations apply to events that occur on or after January 1, 2016 for post-event reporting and for advance reports due on or after that date.

Waivers

In many circumstances, the PBGC automatically waives reportable events, depending on the perceived likelihood that the PBGC may be required to provide guarantees to fund the plan's benefits and the PBGC's access to other sources for the same information. In an effort to reduce the burden of reporting for sponsors that present the least risk, the most significant changes imposed by the final regulations relate to reporting waivers. In particular, the final regulations include less burdensome rules for companies with a low risk of default, plans funded 100 percent or more, public companies already reporting on filings with the Securities and Exchange Commission and small plans:

- **Low Default Risk Waiver.** This waiver applies if each contributing sponsor and the highest level U.S. parent of each contributing sponsor have adequate capacity to meet their financial obligations in full and on time. Adequate capacity is evidenced by satisfying a combination of seven enumerated financial criteria including, among others, a low probability of default on the company's financial obligations (not more than four percent over the next five years and not more than 0.4 percent over the next year), a ratio of total-debt-to-EBITDA of 3.0 or less, a ratio of retained-earnings-to-total-assets of 0.25 or more, and the absence of any loan default event with respect to any loan with an outstanding balance of $10 million or more in the past two years regardless of whether reporting was waived.

  Adequate capacity—which is determined by the contributing sponsor and not the PBGC—is determined once during an annual financial cycle. This determination date, which is known as the financial information date, is based on certain financial statement dates of a company. If a company qualifies, the waiver applies throughout a safe harbor period that ends 13 months later or, if earlier, on the next financial information date. The safe harbor is not available if a company receives an audit or review report that expresses a material adverse view or qualification regarding the company's financial status.

- **Well-Funded Plan Waiver.** This waiver applies if no variable-rate premium (VRP) was required to be paid for the plan year before the year in which the reportable event occurred. Pension plans are required to pay annual premiums to the PBGC and VRP applies to pension plans with unfunded vested benefits.

- **Public Company Waiver.** This waiver applies if any contributing sponsor of a plan is a public company and has filed in a timely manner a Form 8-K disclosing the reportable event under an item of the Form 8-K other than Item 2.02 (Results of Operations and Financial Condition) or Item 9.01 (Financial Statements and Exhibits).

- **Small Plan Waiver.** This waiver applies if the plan had 100 or fewer participants for whom flat-rate premiums were payable to the PBGC for the plan year preceding the event year.

The foregoing waivers apply in the case of the following reportable events: extraordinary dividends or stock redemptions; a change in the contributing sponsor or the sponsor's controlled group; active participant reduction; a transfer of benefit liabilities outside of a plan's controlled group; and, except for the small plan waiver, distribution to a substantial owner of a contributing sponsor of a plan.

The final regulations also provide for event-specific waivers, such as the missed required contribution waiver pursuant to which reporting is waived if the missed contribution is made up within 30 days of its due date and the contribution was missed solely because the plan sponsor failed to make a timely election to use the plan's credit balance to satisfy the funding requirement. Small plans can rely on this waiver if the missed contribution was a quarterly installment.

Finally, there are waivers for reportable events triggered by a foreign entity (other than a foreign parent) or by a company that is not a contributing sponsor of a plan and represents a *de minimis* 10 percent segment of the plan's controlled group.

Definitions of Reportable Events

The final regulations also simplify the definitions of several reportable events. The most notable changes are as follows:

- **Active Participant Reduction.** The final regulations simplify how plan sponsors determine active participant reductions by defining single-cause events (such as a mass layoff or discontinuance of an operation) and employee attrition events. For single-cause events, the measurement date for determining whether reduction exceeds the threshold is the date of the event. For attrition events, the reduction in active participants is measured at the end of the plan year, and the reporting deadline is extended to the PBGC premium due date for the plan year following the event year.

- **Bankruptcy**. The final regulations have eliminated the reporting of proceedings under the U.S. Bankruptcy Code from the insolvency reportable event.

- **Loan Default.** The final regulations require reporting in the case of any default or acceleration of payment on a loan with an outstanding balance of $10 million or more or if the lender waives or agrees to an amendment of any covenant in a credit agreement that results in the cure or avoidance of a breach that would trigger a default.

- **Change of Controlled Group.** The final regulations clarify that a controlled group member's ceasing to exist because of a merger into another controlled group member is not a reportable event.

Assessing the Impact of the Final Rule on Credit Agreements and Corporate Transactions

Credit agreements typically include a slate of provisions relating to reportable events for which the 30-day notice period is not waived. Specifically, a credit agreement may include:

- a representation by a borrower that no ERISA reportable event has occurred that would result in a liability in excess of a specified dollar threshold or result in material liability or a material adverse effect to the borrower;

- reporting covenants requiring the borrower to provide notice of any ERISA reportable event; and

- events of default tied to the occurrence of an ERISA reportable event that would result in a liability in excess of a specified dollar threshold or result in material liability or a material adverse effect to the borrower.

Parties to credit agreements who have tied representations and warranties, reporting covenants and events of default to reportable events will need to assess whether the changes imposed by the final regulations have altered the rights and obligations under existing credit agreements, and will need to be mindful of these changes when negotiating amendments and restatements of existing credit agreements. With respect to the entry into future credit agreements, borrowers would be well-served to make an early determination as to whether they qualify for any of the waivers discussed above. Lenders, however, should focus their attention on whether the waivers would lead to an underreporting of ERISA risks and require tightening of the ERISA-related default terms in credit agreements.

Plan sponsors and parties to credit agreements should be aware that merger and acquisition transactions can trigger a PBGC reporting obligation if the transaction results in a change in the plan sponsor or to the plan sponsor's controlled group, a significant reduction in the number of active plan participants or a transfer of benefit liabilities outside of the controlled group. For such transactions, it is critical to determine if a reporting waiver is available before or immediately after the transaction agreement is signed, because the 30-day reporting period begins on the signing date, not the closing date for the transaction.

If you have any questions about the content of this alert please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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