AREF
American Retirees Education Foundation

NRLN
NATIONAL RETIREE LEGISLATIVE NETWORK

Pension Plan Risks in Mergers, Acquisitions and Spin-offs

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Executive Summary

Certain corporate transactions – particularly the spin-off of under-performing subsidiaries – greatly increase the risk of a distress termination and benefit losses for retirees and other plan participants. Unfortunately, spin-offs can be even more profitable when legacy pension, health and welfare benefits are taken off the books of the parent company. Congress needs to update a number of ERISA provisions to ensure that both pension spin-offs and the merger of plans following M&A activity do not unnecessarily increase the risk of a distress termination and permanent pension losses for plan participants.

The stakes are high for workers and retirees when an under-funded pension plan is terminated or abandoned. Retirees have a common misconception that the Pension Benefit Guaranty Corporation (PBGC) fully guarantees all vested pension benefits. In reality, although most retirees continue to receive their monthly benefit, when an under-funded pension plan terminates it imposes an *immediate and permanent loss of income* on many retirees and other plan participants. The permanent loss of vested but *non-guaranteed* benefits, due to various PBGC limitations, can be devastating to the individuals affected. Although the PBGC has stopped disclosing these losses, its most recent report disclosed that the share of vested benefits permanently lost has risen substantially to 28% on average per participant among the one in seven retirees and participants that lose earned benefits when the agency takes over their plan.

As globalization and the acquisition of American companies by foreign firms and investors becomes increasingly common, there is a particular concern about the PBGC's ability to deter plan terminations by, or recover assets from, foreign-owned or foreign-based plan sponsors and named fiduciaries. The PBGC has had great difficulty persuading either U.S. or foreign courts to attach or enforce a lien against the assets of a plan sponsor outside the territorial jurisdiction of the U.S. Actually collecting on a liability in practice requires that the foreign entities have sufficient assets within the jurisdiction of U.S. courts.

Unfortunately, the PBGC and other federal regulators lack the tools to protect retirees from unnecessary – and unnecessarily severe – terminations. ERISA's outdated and narrow protections create a number of gaps that harm retirees and worsen the PBGC's reported deficits. To its credit, PBGC in recent years has become more aggressive in using its limited statutory authority to negotiate additional contributions that at least delay or mitigate the negative impacts of a distress termination. However, these tools are neither broad enough in scope nor flexible enough with respect to the remedies available when dealing with an under-funded plan. There are major gaps in the law that undermine efforts to prevent a spin-off, acquisition by a foreign-owned entity, an intra-firm plan merger, or other transactions from making a pension plan more likely to default on its pension promises:

First, the PBGC's authority to seek increased funding for a plan or other remedies under ERISA §4042(a) is too limited, since in practice it is restricted to seeking the "nuclear option" of involuntary plan termination, which is itself a worst-case scenario for retirees. Regulators need the ability to temporarily enjoin a plan spin-off or merger and convince a court that a more tailored remedy – such as bonds backed by tangible assets, or amortizing the under-funded liability—is appropriate and practical.

Second, a plan sponsor's immediate liability to fund vested benefits is triggered under ERISA §4062(e) *only if* more than 15% of the *active* participants are separated from the plan, typically due to a plant closing or mass layoff. However, the PBGC has no clear authority to go to court to demand additional funding, to impose leans or to initiate a termination proceeding, if necessary, when a spin-off or other transaction results in the transfer of unfunded benefit liabilities equal to 15% or more of total liabilities.

Third, the PBGC and Department of Labor (DOL) have a very limited ability to either attach or enforce a lien against the tangible assets of a contributing sponsor or other named fiduciary located outside the jurisdiction of the U.S. federal courts. It is not even clear the PBGC can perfect a lien against other U.S.-based assets or subsidiaries of a foreign company that are not part of the plan's controlled group.

Fourth, the PBGC needs to expand the transactions it scrutinizes under its Early Warning Program. The PBGC does not routinely monitor and review two types of transactions that expose the agency and retirees to potentially greater risk of loss: spin-offs (whether or not pension liabilities are transferred) and acquisitions of plan sponsors by non-U.S. firms (whether in whole or in substantial part).

Fifth, intra-firm plan mergers – which often follow M&A activity – should likewise be reportable events, as originally provided under ERISA, and subject to review and pre-approval by PBGC when any of the plans is at-risk (below 80% funded).

Finally, ERISA's definition of who is liable as a plan "fiduciary" will prove meaningless in a growing number of situations where the DOL and PBGC will be unable to hold certain non-U.S. fiduciaries accountable even for knowing and willful breaches of fiduciary duty that deplete plan assets.
The NRLN recommends six changes for legislation, regulatory reform and stepped-up enforcement:

1. **Congress should <u>give regulators broader and more flexible authority under Section 4042(a) to negotiate or seek court approval for a more tailored remedy, short of plan termination</u>**, to address spin-offs or other transactions that greatly increase the risk of future loss to the PBGC and participants.

2. Congress should further <u>amend Section 4042(a) to authorize the PBGC to initiate proceedings to terminate a plan</u>, or seek an alternative remedy short of plan termination, if a spin-off, controlled group break-up, takeover by a foreign entity or other <u>corporate transaction transfers 15% or more of the plan's benefit liabilities</u> without a commensurate and sufficient transfer of assets.

3. Congress should **<u>add the proposed transfer or spin-off of pension assets or liabilities to a foreign controlled group or entity to the list of transactions requiring an Advance Notice of Reportable Events</u>,** triggering special scrutiny under the PBGC's Early Warning Program.

4. Congress should **<u>require that intra-firm plan mergers are reportable events</u>, as ERISA originally required, <u>that require advance notice and review by PBGC</u>,** particularly if any of the plans are in at-risk status, as NRLN proposes in a separate white paper on *Defined Benefit Pension Plan Mergers*.

5. Congress needs to **<u>clarify that the PBGC has the authority to enforce a lien against all U.S.-based assets of the parent company of a foreign-owned plan sponsor</u>** even if those other assets or subsidiaries are not considered part of the controlled group sponsoring the plan.

6. The Department of Labor should revise its regulations to **<u>clarify that fiduciaries under ERISA – especially contributing sponsors and "named fiduciaries" – must be subject to the jurisdiction of federal district courts for the enforcement of judgments for potential breaches of fiduciary duty</u>**.

The whitepaper researched and written for the American Retirees Education Foundation (AREF) is the source of information for this Executive Summary. The AREF expands the research and education reach of the NRLN.
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