[buck research]

fyi® for your information®

Volume 31 | Issue 28 | April 15, 2008

IRS, DOL and PBGC Propose Guidance on PPA Changes for Multiemployer Plans

The Pension Protection Act of 2006 included many provisions that significantly impact multiemployer pension funds. Three federal agencies have recently released guidance to help these funds comply with some of the PPA provisions as well as clarify other issues.

Background

The Pension Protection Act of 2006 (PPA) included the most comprehensive pension funding reforms since the enactment of ERISA in 1974, and changed the landscape significantly for multiemployer plans. (See our October 24, 2006 *For Your Information*.) Within the past few weeks, the IRS issued proposed regulations on the actuary's certification of the funded status of the plan, the DOL issued a proposed model notice for plans in critical status, and the PBGC issued proposed regulations on withdrawal liability and other issues.

IRS Guidance

On March 14, 2008, the IRS issued proposed regulations relating to the actuary's certification of the funded status of multiemployer plans required by PPA, which is due by the 90th day of the plan year.

These regulations generally repeat PPA language and provide limited guidance on issues relating to a multiemployer plan that is in endangered or critical status. However, no guidance is provided on the adoption of a funding-improvement plan or rehabilitation plan. According to the IRS, guidance with respect to these and other issues will be included in a second set of regulations expected to be issued later this year. The IRS is seeking written comments on the proposed regulations by June 16, 2008.

Projections of contribution levels and future employment. PPA established certain snapshot and dynamic tests for determining whether a multiemployer plan is in endangered or critical status. All of the dynamic tests require that the fund actuary project future assets and liabilities. In estimating future contributions, the actuary must either: (i) assume current contributions will continue indefinitely but only if the actuary determines that there have been no significant demographic changes that would make this assumption unreasonable, or (ii) assume that contributions under *one or more* current collective-bargaining agreements will continue for succeeding plan years. However, in determining two of the tests for critical status, the proposed regulations make clear that the

actuary must assume that contributions under all current collective-bargaining agreements will continue for succeeding plan years. With respect to estimating the projected industry activity, the proposed regulations follow the statute by requiring the plan sponsor to provide the actuary with any necessary projection of activity in the industry, including future covered employment. In providing this information, the plan sponsor must act reasonably and in good faith.

Use of funding methods. The proposed regulations require that the unit-credit funding method be used for determining a fund's snapshot funded percentage and for one of the dynamic critical-status tests comparing the fund's current-year costs to anticipated contributions. All other tests are to be conducted using the funding method in place as adopted by the fund's trustees.

> ***BUCK COMMENT.*** *Many multiemployer plans have historically used a funding method more conservative than the unit-credit method. Therefore, use of the required unit-credit method for determining funded percentage might be advantageous for those funds, indicating a better-funded position.*

Extensions of amortization periods. Before PPA, financially challenged funds could apply for an extension of amortization periods for paying off their unfunded liabilities at very short-term (generally lower) interest rates. Treasury, however, granted few such requests. Under PPA, an automatic five-year extension at the same interest rate assumed by the actuary for plan funding is available for plans that meet certain requirements. An additional five-year extension may be sought by an application to the Treasury.

PPA's dynamic funding tests for endangered or critical status require amortization extensions to be reflected in some circumstances and ignored in others. The proposed regulations clarify that references to amortization extensions include the older pre-PPA extensions that some funds were granted as well as the new extensions defined under PPA.

Content and addressees of the actuary's certificate. While PPA requires the actuary's annual certificate to state whether or not the fund is in endangered or critical status, it provides little information on what else to include in the certificate and where it should be sent. The proposed regulations provide that the following information should be included in the certificate –

- the name of the plan, the plan number, the name, address and the telephone number of the plan sponsor, and the plan year for which the certification is being made
- the name, address and telephone number of the enrolled actuary signing the certification, the actuary's enrollment number, the actuary's signature and the date of the signature
- whether the plan is in endangered status, critical status, or neither endangered nor critical status
- if the annual certification is made with respect to a plan year that is within the plan's funding-improvement period or rehabilitation period, whether or not the plan is making scheduled progress in meeting the requirements of its funding-improvement or rehabilitation plan.

The proposed regulations also provide that the certificate should be sent to a specific address at Treasury as well as to the plan sponsor at its address as shown on the fund's most recent filing of Form 5500. The IRS stated that it may modify or augment the required certificate contents in the future.

For those funds that were certified early. Some funds were anxious to have their funded status determined early so as to begin using tools available to them under PPA as soon as possible. If certificates filed before the issuance of the proposed regulations did not comply with all the requirements of the proposed regulations, the benefit restrictions under PPA for funds in critical status are generally deemed inapplicable and the fund must have its actuary refile a fully conforming certificate on a timely basis. In addition, if a fund was certified in critical status and participants were notified that certain benefit restrictions might apply, but it is later determined that the restrictions should not have been applied, the fund must correct any benefit payments that were restricted in error.

Penalties. The proposed regulations reiterate the PPA provisions penalizing the fund administrator for failure to secure a timely actuarial certification. Specifically, failure to obtain an actuarial certification will be treated as failing to file the Form 5500. The penalty for the failure is up to $1,100 for each late day.

DOL Model Notice

Under PPA, multiemployer funds that are in or will be in endangered or critical status must provide notice of this status to participants and beneficiaries, the bargaining parties, the PBGC and the DOL within 30 days after the date of the fund actuary's certification. PPA required the DOL to issue a model notice for funds in critical status, which it did on March 25, 2008, after consultation with both the PBGC and the IRS. The DOL is seeking written comments on the notice by April 24, 2008.

The DOL was not required to, nor did it venture to, offer a model notice for plans in endangered status. However, in its commentary, the DOL indicated that the model notice for critical status may be useful in preparing notices required to be furnished by plans in endangered status.

> ***BUCK COMMENT.*** *Although the DOL indicated that the model notice for critical status may be useful in preparing endangered status notices, the requirements and results for each status are very different. Therefore, to avoid confusion, a plan sponsor may not want to use the model notice in drafting a notice of endangered status.*

Funds should either mail notices to the U.S. Department of Labor, Employee Benefits Security Administration (EBSA), Public Disclosure Room, N-1513, 200 Constitution Ave., NW, Washington, DC 20210, or e-mail notices to criticalstatusnotice@dol.gov. Notices of funds' critical status received by the DOL will be available for public inspection at the Public Disclosure Room, and accessible on EBSA's website.

In addition, funds should either mail notices to Program Division, Pension Benefit Guaranty Corporation, 1200 K Street, NW, Suite 930, Washington, DC 20005, or e-mail notices to multiemployerprogram@pbgc.gov.

BUCK COMMENT. *Neither the statute nor the model notice provide how this information should be sent to participants and beneficiaries or the bargaining parties. Until guidance is provided, it may be safe to assume that notice may be provided to participants and beneficiaries in a manner that is consistent with other required disclosures under ERISA, such as summary plan descriptions.*

Although the final regulations will be effective 60 days after the date of their publication, funds that accurately complete and timely furnish the required notice prior to that time based upon the proposed model will be deemed by the DOL and IRS as having satisfied the notice requirements under PPA.

The model notice discusses the possibility of reductions to "adjustable benefits". In addition, the notice suggests the fund include a description of the PPA test under which it has been deemed critical by its actuary.

BUCK COMMENT. *Because the descriptions of the PPA tests in the model notice are in very technical language that fund participants will not understand, their use could result in much confusion for recipients.*

Contribution Surcharges. The model notice also informs contributing employers about the automatic contribution surcharge of 5% of bargained-for contributions in effect, with the surcharge to become effective during the first year of the fund's critical status. Although not specifically mentioned in the model notice, PPA mandates that the surcharge cannot become effective until 30 days after the employer is so notified. Presumably, furnishing this model notice to the bargaining parties will begin the 30-day clock, at the end of which time the fund could demand payment of the contribution surcharge.

PBGC Proposed Regulations

The PBGC published proposed regulations on March 19, 2008, which provide guidance on some PPA issues, but leave others open. They also address some non-PPA issues. Comments on these regulations are requested by May 19, 2008.

The Presumptive Method. The presumptive method for allocating withdrawal liability apportions the annual change in the present value of the unfunded vested benefits for each plan year ending after September 26, 1980 to each contributing employer, with the amount of each annual change being written down by 5% over the subsequent 20 years (sometimes referred to as the "20-pool" method).

Consistent with the PPA changes, the proposed regulations allow a fund to adopt through amendment a newly designated plan year in which there are no unfunded vested benefits as a substitute for the "last plan year ending before September 26, 1980." Such an amendment would enable a fund to erase a large part of the unfunded vested benefits attributable to plan years before the end of the designated plan year, and to start fresh with liabilities that arise in plan years after the designated plan year. It would also allow a fund to ignore past years for which reliable contribution data, which is needed for the required allocation fractions, may not be readily available. Finally, the changes provide an opportunity to establish better procedures for prospectively retaining the required

contribution information. This change would generally be applicable to employer withdrawals occurring on or after January 1, 2007.

A similar change – though not available for funds that primarily cover employees in the building and construction industry – would allow a fund to adopt a newly designated plan year *regardless* of the amount of the unfunded vested benefit liability as a substitute for the "plan year ending before September 26, 1980." This change would generally be applicable to employer fund withdrawals occurring on or after the effective date of the final regulations.

Modified Presumptive Method. The "modified presumptive" method established two pools of liability to be allocated to withdrawing employers – one for the "last plan year ending before September 26, 1980" and the other equal to the unfunded vested benefits as of the plan year prior to an employer's withdrawal. The first of these two pools was to be amortized over 15 years and has essentially disappeared since 1995. The proposed regulations would allow a fund otherwise eligible to use this method to adopt a newly designated plan year regardless of the amount of the unfunded vested benefit liability as a substitute for the "plan year ending before September 26, 1980."

For a period of time, this modification would reduce new employers' liability for unfunded vested benefits before the employer's participation, which could assist plans in attracting new employers and preserving the plan's contribution base. The proposal would not require PBGC approval for adoption.

This change would generally be applicable to employer fund withdrawals occurring on or after the effective date of the final regulations.

Critical Status. For funds in critical status under PPA, certain reductions in accrued benefits may be allowed and employers may be assessed contribution surcharges. Because determinations of withdrawal liability depend heavily on a fund's benefit promises and contribution histories, the drafters of PPA recognized these provisions' effects on withdrawal liability. Accordingly, PPA required that these changes be ignored when calculating withdrawal liability, essentially establishing "two sets of books" for a fund. The proposed regulations reiterate the PPA provisions and provide numerical examples.

These changes would be applicable to employer withdrawals from a plan and plan terminations by mass withdrawals (discussed below) occurring for plan years beginning on or after January 1, 2008.

Mass Withdrawal. ERISA applies special withdrawal liability rules when a multiemployer plan terminates because of a mass withdrawal (i.e., the withdrawal of every employer under the plan, or when substantially all employers withdraw pursuant to an agreement or arrangement to withdraw within a three-year period). To ensure that all unfunded vested benefits are fully allocated among all liable employers, ERISA requires a determination of the plan's unfunded vested benefits as of the end of the plan year of the plan termination. This determination is based on the value of the plan's nonforfeitable benefits as of that date minus the value of plan assets (where benefits and assets are valued in accordance with assumptions specified by the PBGC), minus the outstanding

balance of any initial withdrawal liability (assessments without regard to the occurrence of a mass withdrawal) and any redetermination liability (assessments for *de minimis* and 20-year cap reduction amounts) that can reasonably be expected to be collected. Each liable employer's share of this "reallocation liability" is allocated via a fraction, the numerator of which is the sum of the employer's initial withdrawal liability and any redetermination liability, and the denominator of which is the sum of all initial withdrawal liabilities and all the redetermination liabilities of all liable employers.

The PBGC believes the current allocation fraction for reallocation liability must be modified to address those situations in which employers who would otherwise be liable for reallocation liability have little or no initial withdrawal liability or redetermination liability and, therefore, have a zero (or understated) reallocation liability. In the preamble to the proposed regulations, the PBGC listed three examples of where this might occur.

- First, where an employer withdraws from the plan before the mass withdrawal valuation date, but has no withdrawal liability under the modified presumptive or rolling-5 method because either (i) the plan has no unfunded vested benefits as of the end of the plan year preceding the plan year in which the employer withdrew, or (ii) the plan did not require the employer to make contributions for the five-year period preceding the plan year of withdrawal. In these cases, if the employer's withdrawal is later determined to be part of a mass withdrawal for which reallocation liability applies, the employer would not be liable for any portion of the reallocation liability.
- Second, a plan's status may change from overfunded to underfunded between the employer's withdrawal and the mass-withdrawal valuation date as a result of differences in the actuarial assumptions used by the plan's actuary in determining unfunded vested benefits or due to investment losses that reduce the value of the plan's assets.
- Third, an employer may not have paid contributions for purposes of the allocation fraction used to determine the employer's initial withdrawal liability if the plan provided for a "contribution holiday" (under which employers were not required to make contributions).

The PBGC believes the absence of initial withdrawal liability should not generally exempt an otherwise liable employer from reallocation liability. By inadvertently shifting reallocation liability away from some employers, the allocable share of other employers in a mass withdrawal is unfairly increased, which also increases the risk of a loss of benefits to participants and to the PBGC.

To ensure that reallocation liability is allocated broadly among all liable employers, the PBGC proposes to replace the current allocation fraction based on initial withdrawal liability with a new allocation fraction based upon contribution base units.

This change would apply to mass withdrawals that occur on or after the effective date of the final regulations.

BUCK COMMENT. *After testing various examples, it appears that the PBGC's "repaired" allocation fraction will rarely add up to 100% for all affected employers. Most of the scenarios we have examined indicate this fraction will more likely be greater than 100%. Perhaps after the PBGC receives comments, it will allow adjustment in this new fraction so as to apportion exactly 100% of the reallocation liability to all affected employers.*

Contesting an Assessment of Withdrawal Liability. The proposed regulations also reflect the PPA provision that relieves an employer that contests a demand for withdrawal liability in certain narrowly defined circumstances of the obligation to make withdrawal liability payments until a final arbitration or court decision upholds a fund's determination that the employer is in fact liable for withdrawal liability. The regulations state that such an employer that complies with the current required procedures applicable to certain disputes would not be in default under ERISA.

This change would be effective for an employer that receives a notice and demand for withdrawal liability on or after August 17, 2006 (the date of PPA enactment) with respect to a transaction that occurred after 1998.

Conclusion

The regulating agencies have begun to issue guidance that will help in the implementation of the complex provisions of PPA for multiemployer plans. While some of the guidance has been expected, some appears to have been issued with an eye toward offering welcome administrative simplifications to multiemployer funds. It is expected that the regulating agencies will continue to issue guidance that will have more impact on funds and contributing employers. Buck's consultants have the relevant multiemployer expertise, and can assist you with reviewing and assessing the potential impact of these changes on your funds.