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ERISA@40: Revisiting a Key Concept

This is the sixth article in a multi-part series of articles celebrating the 40th birthday of the Employee Retirement Income Security Act. ERISA was signed into law by President Gerald Ford on September 2, 1974 — Labor Day. This landmark law regulates many aspects of employer-sponsored retirement and welfare benefit plans. The series looks back to explore how the employee benefits industry has evolved, highlights lessons learned, and looks forward to what employers may expect in the future.

This article examines a key ERISA concept — the anti-cutback rule, and proposals to limit the rule in the context of retirement plans and expand its application to retiree health coverage.

Background

Prior to ERISA, termination of an underfunded pension plan would often leave participants without meaningful retirement benefits. The shutdown of the Studebaker plant in South Bend, Indiana in 1963 is the oft-noted example of this sad result. Studebaker's shutdown left thousands without a pension and ignited a decade of legislative debate that resulted in the passage of ERISA in 1974. While ERISA does not mandate the creation of a pension plan nor specify what kind of benefits an employer must provide, Congress wanted to ensure that if a promise of a defined benefit at retirement is made, that promise would be honored should an employee satisfy all the conditions of obtaining a vested benefit.

Minimum funding rules are part of honoring an employer's pension promise, and those rules are a fundamental part of ERISA. However, minimum funding alone would not be effective if the plan sponsor could change the promise. To ensure those promises could not be compromised, ERISA generally prohibits amendments that reduce or eliminate benefits that participants have already accrued based on past service. This anti-cutback rule is fundamental to ERISA's goal of protecting an employee's expectation of earning and enjoying pension benefits. ERISA

Health and Welfare Benefit Plans

While ERISA provides anti-cutback protections to participants in retirement plans, sponsors of welfare benefit plans are generally permitted to reserve the ability to unilaterally reduce — or eliminate — welfare benefits, such as retiree medical coverage.

further protects employee expectations by providing minimum vesting, service, and benefit accrual standards, but these standards — like minimum funding — would also be meaningless if benefits could be reduced at any time with plan amendments.

In 1984, under the Retirement Equity Act, the protection of the anti-cutback rule prohibiting plan amendments that reduce or eliminate an accrued benefit was expanded to include early retirement benefits, retirement-type subsidies, and optional forms of benefits. Courts have also taken an expansive view and have ruled that automatic cost-of-living adjustments may also be protected as accrued benefits.

Exceptions to the Anti-cutback Rule

There are some notable exceptions to the anti-cutback rule. ERISA included a limited administrative exception that allowed retroactive adoption of amendments reducing accruals back to a prior year (2½ months post plan year-end amendments for single employer plans and two years post plan year-end amendments for multiemployer plans). Plan sponsors need to get specific IRS approval for this relief.

In addition, legislation changing the rules from time to time includes “anti-cutback relief” to ease the transition to the new legislated changes. For example, the Retirement Protection Act of 1994 explicitly exempts from the anti-cutback rule a plan amendment to use the 30-year treasury rate in lieu of the monthly PBGC rate to calculate the value of a lump sum distribution.

In 2005, authorized by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the IRS issued regulations that would, in certain circumstances, allow plan sponsors to reduce the number of optional forms of benefits and to eliminate or reduce an early retirement or retirement-type subsidy that creates significant burdens or complexities for the plan and its participants.

Multiemployer Exceptions Break New Ground

Under the Pension Protection Act of 2006 (PPA), for plans in severe distress or “critical status”, trustees were allowed to eliminate certain protected benefits, such as early retirement subsidies, death benefits, and disability benefits not in pay status. These legislative actions would have the backing of the Supreme Court in light of their remarks in a 1984 decision on retroactive multiemployer withdrawal liability (PBGC v. Gray) “…[O]ur cases are clear that legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations.”

Public Plans

Governmental plans are not subject to ERISA, and participants in these plans are not protected by the ERISA anti-cutback rule. Instead, these plans enjoy unique protections typically based on the constitution of each of the states. Generally, these protections address not only the accrued benefits of plan participants, but also the future rate accrual promised at the time of initial employment. Read about these non-ERISA protections in our April 23, 2014 *For Your Information*.

Further Exception Proposed

Currently the complicated multiemployer pension plan system is undergoing some challenging times, and its future success will be determined by a myriad of changing factors. After the market crash of 2008, the decrease in employer participation in these plans, the PBGC deficit for its multiemployer plan insurance program, and with the PPA funding rules for distressed multiemployer plans set to expire at the end of this year, this topic is likely to be the focus of new legislation and difficult decisions.

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In particular, a number of multiemployer pension plans are in severe financial distress — and are likely to become insolvent and possibly bankrupt the PBGC's insurance program. A leading industry group has proposed waivers from the anti-cutback rule for these plans as a means of staving off insolvency — giving the trustees as many tools as possible to allow these plan to remain solvent and preserve benefits above the PBGC guarantee level.

Scope of the Problem

The PBGC's FY 2013 Projection Report details the severe funding problems faced by some multiemployer pension plans. About 200 out of the more than 1,400 multiemployer plans in the nation are distressed; these collectively cover 1.5 million participants out of the 10.4 million participants in multiemployer plans.

If these distressed plans are forced into insolvency, a number of ramifications will follow:

- Plan participants. For plan participants, significant reductions in benefit payments are a consequence since the PBGC guarantees for multiemployer plans are very low — and that's assuming that the insurance program remains solvent and can pay the full guarantee. The full guarantee depends on the participant's years of service, with a full current PBGC guarantee of $12,870 annually for a participant with 30 years of service. PBGC estimates that even with this guarantee, participants who are paid the maximum guarantee face a benefit cut of almost 20%.
- PBGC's insurance program. Possible insolvency of the PBGC's insurance program for multiemployer pension plans is another potential consequence given the number of plans involved and the size of the liabilities — which would force the PBGC to cut guaranteed benefits so that outflows match incoming premium receipts. The agency estimates that the insurance program for multiemployer pension plans will likely deplete its assets by the end of calendar year 2022.
- Contributing employers and healthy multiemployer pension plans. The bankruptcy of contributing employers is a potential consequence as distressed plans seek contributions to forestall insolvency. This could create a domino effect in other, healthy multiemployer pension plans — particularly in the event of the failure of a very large plan — because many employers contribute to more than one plan.

The PBGC estimates that its multiemployer insurance program faces a projected deficit in 2022 of almost $50 billion — the same year that the PBGC projects that its insurance program for such plans will exhaust its assets and become insolvent.

The Proposed Solution

A commission established by the National Coordinating Committee for Multiemployer Plans (NCCMP) published a proposal in January 2013 to comprehensively address multiemployer plan funding issues. The report — Solutions not Bailouts — has three chief goals: preservation of the current system; remediation of deeply troubled plans; and innovation for future plan design.

The key proposal for the second goal — remediation of troubled plans — would involve changes to ERISA's anti-cutback rule. Under the proposal, such plans would be permitted to suspend participant benefits — including the benefits of those in pay status. A plan would not be permitted to suspend benefits below 110% of PBGC guaranteed benefits for the participant. Additionally, amounts suspended must not be more that the amount necessary for the plan to avoid insolvency, and the PBGC would be required to approve any benefit suspensions. PBGC approval would extend to the plan's proposed distribution of the suspension among plan participants — with the PBGC considering factors such as whether the suspension is equitably distributed among all participants and whether the most vulnerable segments of the plan's populations have been protected.

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The proposal contemplates that benefit suspensions could be temporary if the plan is able to avoid insolvency and regain sound financial footing. Thus the proposal requires that any future benefit improvement must be accompanied by an equitable restoration of prior benefit suspensions.

The ability to suspend plan benefits would be limited to plans that are projected to become insolvent within 15 years, or to plans with a projected insolvency within 20 years, provided that the ratio of inactive to active participants is greater than 2 to 1.

Policy Implications

The NCCMP's proposal to limit the anti-cutback rule presents several challenges having significant implications for all involved.

Chipping Away at Anti-Cutback Rule

The PPA permits underfunded multiemployer "critical status" plans — referred to as red zone plans — to reduce certain accrued benefits, such as early retirement subsidies or subsidized optional forms of payment.

The PPA's relaxation of the anti-cutback rule is limited though — it cannot be used to reduce a participant's normal retirement benefit and it cannot be used for participants in pay status.

In contrast, neither of these restrictions would apply to the NCCMP proposal.

For the PBGC and employers, the proposal provides a relief valve that may help to avoid employer and PBGC insurance program insolvency. The proposal might also make multiemployer plans somewhat more attractive for employers to sponsor. For the PBGC, the proposal would require the agency to devote significant resources to developing in-house expertise to review the fairness of benefit suspensions — a pivotal element of the proposal that will likely result in judicial scrutiny.

For multiemployer pension plans themselves, the proposal would allow severely distressed plans headed for insolvency a chance to regain their footing. And the proposal would also preserve the finances of healthy plans that rely on employers that contribute to both healthy and nonhealthy plans. This safer footing, however, might — and arguably should — come at the price of closer scrutiny of plan operations and finances — with government agencies, courts, and litigants watching plan financial and investment decisions even more closely.

With benefit suspensions, the proposal asks the most from plan participants. Given this, the ability to suspend benefits is intended to be limited and protective of the most vulnerable population in an effort to ensure the viability of the plan.

Expanding the Reach of the Anti-Cutback Rule

Legislation has been introduced in this Congress that would expand the protection of the anti-cutback rule for retiree health coverage — S. 2418, introduced by Senators Jay Rockefeller (D-WV) and Elizabeth Warren (D-MA), and H.R. 5523, introduced by Louise Slaughter (D-NY). Among other changes to current law, the bills would alter the burden of proof in lawsuits challenging a reduction or elimination of retiree health benefits by creating a rebuttable presumption that the benefits are fully vested when an employee retires or completes 20 years of service. To rebut this presumption, the employer would have to show (under a clear and convincing evidentiary standard) that the employer had the right to modify or terminate benefits, and the employee was made aware in clear and unambiguous terms of the employer's right to do so before becoming a participant in the plan.

The prospects for enactment of these bills in this Congress are unlikely.

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The proposal changes a key advantage of defined benefit pension plans — which is that contributing employers bear the risk of loss if plan assets are insufficient to pay plan liabilities. Without this, a defined benefit plan would offer fewer advantages over a defined contribution plan, particularly when the defined contribution plan's investments are professionally managed, plan leakage is limited, and the plan offers longevity annuities.

In Closing

Legislation based on the NCCMP's proposal has yet to be introduced in Congress. However, the challenges faced by severely distressed multiemployer pension plans are likely to be a focus of the 114th Congress — slated to begin in January 2015. The PBGC's fiscal year 2013 Projection Report elicited press releases from various committees pledging to study the issue more closely — for example, the Education and Workforce Committee in the House of Representatives and the Senate Finance and Health, Education, Labor and Pension Committees. (See our October 3, 2014 *Legislate*.) It remains to be seen when and if Congress does take up multiemployer pension plan funding whether changes to the anti-cutback rule will be on the table.

ERISA@40 Series

We've issued five publications in the ERISA@40 series:

ERISA@40: A History Lesson August 13

ERISA@40: ERISA Preemption and the ACA August 20

ERISA@40: ERISA, COBRA, and the ACA August 27

ERISA@40: Happy Birthday, ERISA! September 2

ERISA@40: ERISA, Nixon, and the ACA September 18

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