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**Authors**
Bob Wright, FSA, EA, MAAA
David F. Harwood, Jr., EA, MAAA
Alice Hicks, JD, EA, FCA, ASA

# PBGC issues proposed regulations on interest rate assumptions to use for calculating withdrawal liability

On October 14th, the PBGC issued a proposed regulation providing guidance on interest rate assumptions that may be used in determining a withdrawing employer's liability under a multiemployer plan when an employer completely or partially withdraws. The proposed rule clarifies that ERISA Section 4044 settlement-based interest rates already prescribed by the PBGC for *mass withdrawal* situations are deemed to be reasonable in all withdrawal liability determinations. The proposed rule would specifically permit the use of ERISA Section 4044 rates as reasonable either as a standalone assumption, or combined with funding interest rate assumptions, to determine withdrawal liability from ongoing plans.

## Background

ERISA Section 4044 and PBGC regulations prescribe actuarial assumptions for determining withdrawal liability in a multiemployer plan that terminates by mass withdrawal. ERISA Section 4213(a)(2) has always given the PBGC statutory authority to issue regulations setting forth the assumptions that an ongoing plan may use to calculate an employer's withdrawal liability. Until now, the PBGC has not done so.

In the absence of explicit guidance, there has been a diversity of practice across the multiemployer actuarial community. Common approaches to selecting the withdrawal liability interest rate include using the funding interest rate that aligns to the expected return on plan assets, using market-observed interest rates (like the ERISA Section 4044 rates that PBGC publishes quarterly based on its survey of insurance company annuity prices), or using a blend of these two approaches.

The practice of selecting withdrawal liability interest rates has received intense scrutiny in recent years. In the absence of explicit guidance, actuaries are obliged to select withdrawal liability

assumptions relying on relevant facts and circumstances, actuarial standards of practice, and professional judgment. Disputes regarding this assumption between plans and employers are resolved through mandatory arbitration and then, if necessary, litigation.

## Calculating a plan's vested benefit liability

A plan's vested benefit liability is the present value of the payments that the actuary anticipates the plan will pay to all current vested participants with respect to non-forfeitable benefits earned to date. When calculating a plan's vested benefit liability, ERISA Section 4213(a)(1) requires the use of actuarial assumptions that are, "in the aggregate", "reasonable" based on the plan experience and reasonable expectations. In combination, they must offer "the actuary's best estimate of anticipated experience under the plan." The most significant actuarial assumption is often the interest rate (or rates) used to discount future expected payments to a present value. Higher interest rate assumptions result in a smaller withdrawal liability; lower interest rate assumptions lead to a larger withdrawal liability.

## Actuarial variety in selecting the interest rate assumption for calculating withdrawal liability

Until now, plans have used a variety of approaches for selecting the interest rate assumption used to determine a plan's vested benefit liability.

- One common approach uses the same interest rate assumption that is used to determine minimum funding requirements. Unlike single-employer funding requirements, this rate is generally based on the expected average return on plan assets over the long term. Under this approach, the process of selecting the interest rate assumption typically involves:

  — Developing expected returns for different asset classes (such as stocks, bonds, and alternative investment classes); and

  — Determining the expected return on plan assets based on the distribution of the plan's investment portfolio across the various asset classes.

  Using an interest rate equal to the expected return on plan assets represents the actuary's best estimate of the amount of money today that will be needed to satisfy the plan's future obligations. In other words, if the plan returns exactly the expected return in every year and all other assumptions are satisfied, then it will spend its last dollar on the final payment to the last surviving participant.

- A second approach bases the assumption on observations of market data. Current Actuarial Standards of Practice cite both the yields available on various types of bonds and current annuity prices as potential sources of observation for this purpose.

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Many classes of bonds trade in highly liquid and transparent markets, but it may be difficult to obtain the assumptions embedded in annuity quotes provided by insurance companies. The PBGC publishes interest rates each quarter based on its survey of insurers, which are mandated for determining withdrawal liability for multiemployer plans in mass withdrawal. Given the scarcity of alternatives, some actuaries choose the PBGC's published interest rates as a measure of annuity pricing data and determine a plan's vested benefit liability using those rates.

Using a market-observed interest rate is typically consistent with an estimate of the cost of settling a pension liability. Many practitioners believe this is consistent with the purpose of the measurement, given that the withdrawing employer is settling its obligation to the plan.

- A third approach uses an interest rate assumption that employs a blend of the first two approaches. For example, the actuary might value unfunded benefits using the funding interest rate assumption, and value funded benefits using a settlement interest rate assumption like ERISA Section 4044 rates.

## Recent disputes

Litigation over withdrawal liability determinations has been increasing, centered on the interest rate assumption. In five cases since 2018 (and an unknown number of arbitrations), a withdrawing employer has argued that the interest rate assumption failed to satisfy ERISA Section 4213(a)(1). Court decisions have varied, and some of the decisions have relied in part on the PBGC's unused authority to prescribe assumptions.

## Overview of regulation

The proposed regulation makes it clear that using ERISA Section 4044 rates represents a valid approach to selecting an interest rate assumption to determine withdrawal liability in all circumstances. This is the mandated approach the PBGC has required for all plans that apply for and receive special financial assistance under the American Rescue Plan Act of 2021 (ARP), so they have extended that logic to all plans including those that are healthy enough to avoid financial assistance. If a withdrawing employer were to shift all investment, mortality, and other risks to an annuity provider, it would have to pay the premium amount necessary to fund the promised pension liability. Accordingly, it is reasonable to base the amount needed to settle the employer's share of the liability on the market price of settling pension liabilities by purchasing annuities from private insurers.

While the proposed regulation specifically permits the use of ERISA Section 4044 rates, it does not specifically disallow any other type of interest rate assumption. Other assumptions must be reasonable (considering plan experience and reasonable expectations) and in combination represent the actuary's best estimate of anticipated experience under the plan. The proposed rule specifically permits the use of an interest rate anywhere in the range from ERISA Section 4044 rates alone to the plan's funding interest rate alone.

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Subject to public comment, the PBGC proposed regulation has effectively declared a wide range of rates reasonable and no longer subject to challenge or arbitration, saving litigation costs for plans and providing another means to shore up plan funding and protect the PBGC's financial interests. The PBGC also stated within the proposed regulation that they now expect more funds to use the ERISA Section 4044 rates and collect more in withdrawal liability.

## Request for comments

The PBGC requests comments on whether the final rule should restrict the allowable options to a narrower range of interest rates or to only specific methodologies for determining interest rates. Specifically, should the top of the range of permissible rates be lower than the typical funding interest rate assumption (which reflects a portfolio with a significant allocation to return-seeking assets)? The PBGC also requests comments on what extent, if any, the permissible range of assumptions should depend on the estimated date of plan insolvency, expected investment mix, and/or funded ratio.

Each assumption and method used other than the interest assumption, which has now been specifically prescribed, must still comply with ERISA Section 4213(a)(1). Each would have to be reasonable on its own (taking into account plan experience and reasonable expectations) and in combination represent the actuary's best estimate of anticipated experience under the plan. The PBGC requests comments on whether the final rule should prescribe specific assumptions or methods in addition to the interest rate assumption. Also, if the PBGC were to prescribe other assumptions that differed from those currently used by a plan, how would that affect the plan sponsor's decision to use the prescribed assumptions?

## Applicability and effective date

The proposed rule would apply to the determination of withdrawal liability for employer withdrawals from multiemployer plans that occur on or after the effective date of the final regulations. That, however, does not preclude the use of the proposed interest rate assumptions before the effective date.

## In closing

Collecting greater sums from exiting employers without risk of arbitration or challenge will be welcome news to multiemployer plans but not-so-welcome news to participating employers who might be considering withdrawing from the plan(s) in which they participate. The proposed changes offer cover and support for calculating withdrawal liabilities at more conservative settlement rates, which will result in higher liabilities and make it more expensive for participating employers to exit.

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