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Outlook 2015

Multiemployer, 4062(e) Changes Enacted, And Now It's Time to See How It Shakes Out

Congressional negotiations over a budget bill late last year introduced a landmark change to ERISA on the law's 40th anniversary: To preserve their multiemployer defined benefit plans, trustees and participants can now voluntarily decide whether to reduce benefits instead of waiting for plan insolvency.

The change is likely to have a major impact on the Pension Benefit Guaranty Corporation and multiemployer plans in 2015.

Some plans will be moving as quickly as possible now that they have the legal tools to do so, such as the financially troubled Central States Pension Fund, although the fund, one of the largest in the nation, said any changes likely wouldn't take effect for at least a year.

The multiemployer plan provisions were included in the Multiemployer Pension Reform Act of 2014, which was included in the budget bill known as ''cromnibus'' (a portmanteau of continuing resolution and omnibus).

The Pension Benefit Guaranty Corporation will be releasing guidance in the first quarter on the new law, but the agency has a number of other things on its slate for 2015 as well, agency officials told Bloomberg BNA.

The PBGC also will be revisiting its guidance on:

- withdrawal liability triggered by a substantial cessation of operations under Employee Retirement Income Security Act Section 4062(e), which Congress revised in the budget bill;
- its early warning program under ERISA Section 4042(a)(4);
- gathering information on pension plan de-risking; and
- termination audits.

The officials spoke on various agency-related issues and aspects of its agenda for 2015 on the condition they not be named.

'An Uncomfortable Compromise.' Congress's adoption of the revision of ERISA's anti-cutback provisions was ''an uncomfortable compromise, like most compromises are,'' that will protect pensioners in plans that are at risk of insolvency from seeing their benefits drop all the way to the PBGC's guaranteed levels, one of the agency officials said.

For 2015, the maximum annual guarantee level for a multiemployer plan retiree with 30 years of service is $12,870, the same limit that has been in place since 2001 (208 PBD, 10/28/14).

Prior to the congressional revision of the anti-cutback rule under tax code Section 411(d)(6), a plan couldn't be amended to retroactively eliminate or reduce a pension benefit that had already accrued by the date of the adoption of the amendment.

Under the revised provisions, trustees of seriously endangered plans have the discretion to drop benefits to as low as 110 percent of the PBGC's maximum guaranteed benefit level to protect plan solvency, provided plan participants, contributing sponsors and the Treasury Department all agree. Reductions don't apply to participants who are age 80 and above, and are phased out for participants ages 75 to 80. In addition, plans can't suspend disability benefits. Benefit reductions also must be equitably distributed across the participant population.

Benefit reductions are allowed only if the plan trustees determine that all reasonable measures to avoid insolvency have been and continue to be taken, but the plan is still considered headed for insolvency and suspensions would allow the plan to avoid insolvency indefinitely.

In testimony at a hearing held by a House Education and the Workforce Committee panel in October 2013, Thomas C. Nyhan, Central States' executive director and general counsel, said that the fund was facing insolvency within 10 to 15 years if it couldn't substantially reduce its liability with a large influx of assets (211 PBD, 10/31/13).

Using the market value of assets at the time, Central States was funded at about 53 percent of its funding obligations, Nyhan said.

Other multiemployer plans will be joining Central States in trying to reduce benefits, said Joshua Gotbaum, a guest scholar in the economic studies program at the Brookings Institution in Washington and director of the PBGC from 2010 to August 2014 (134 PBD, 7/14/14), said in an interview.

Central States is a member of the National Coordinating Committee for Multiemployer Plans, a coalition of unions and plan sponsors that lobbied Congress for passage of a package of proposals to revamp the multiemployer system laid out in the 2013 report ''Solutions Not Bailouts'' (34 PBD, 2/20/13). The Multiemployer Pension Reform Act largely reflects the NCCMP's recommendations on revising the anti-cutback provisions.

Central States was the most aggressive in pushing for an ability to save itself, but other plans that were unwilling to admit their financial condition will now be com-

ing forward and requesting to use the new legal tools, Gotbaum said.

''Will Central States be there earlier and on a more organized basis because they've been thinking about this for years? Of course they will. But are they going to be alone? Absolutely not,'' he said.

The cutback provisions would apply only to the most at-risk plans—5 percent to 10 percent of the multiemployer plan universe—but because of a ''drumbeat out there that everybody will lose benefits,'' the NCCMP will be trying to make sure that plan participants have nothing to fear, said Randy G. DeFrehn, executive director of the NCCMP in Washington.

Repeal? One of those drummers is the Pension Rights Center, which will ''work in every way we can to repeal the cutback provisions,'' said Karen Ferguson, director of the PRC, and Karen Friedman, executive vice president and policy director of the organization.

Ferguson and Friedman said they have a precedent on their side for such a repeal. The Tax Reform Act of 1986 included a Section 89 that mandated the allocation of health benefits to a wide cross-section of employees in a nondiscriminatory fashion. But after heavy criticism from small employers, Congress repealed the section in 1989 (10 PBD, 1/16/09).

The Section 89 example applies because it was passed in the same manner as the ERISA cutback provisions, Friedman said: It was ''an 11th-hour attachment to a must-pass bill'' that sailed through Congress without adequate consideration.

''I think there's going to be a lot of effort to stop this thing in its tracks,'' Friedman said. ''The fact that folks pushed this through in the dead of night and it's going to have such an extreme impact on the most vulnerable citizens of our country should really make Congress sit up and take notice.''

Ferguson and Friedman said they are also working closely with Treasury to see how the department can minimize potential damage from the new law. Meanwhile, they have already heard from lawyers who have expressed interest in bringing legal challenges to the law, they said.

DeFrehn, meanwhile, is looking beyond the cutback provisions to another recommendation that the NCCMP made for innovating hybrid plans, which include both defined benefit and defined contribution features, that would allow plan administrators to adjust benefit levels when needed.

The House Ways and Means Committee wanted more time to vet the idea, DeFrehn said, and added that Rep. Paul D. Ryan (R-Wis.), chairman of the panel, has promised ''to move it across the line.''

Partition Authority. The multiemployer provisions also expanded the PBGC's authority and funding to partition plans that are in critical and declining status.

Under ERISA, the agency can partition multiemployer plans to allow financially healthy employers to maintain a plan by carving out the plan liabilities attributable to employers that have filed for Chapter 11 bankruptcy.

The PBGC has partitioned only three plans in its 40-year history, in 1983, 2010, and most recently in early 2014 (22 PBD, 2/3/14).

With the new law in hand, the PBGC will probably provide partitioning for ''many, many, many'' plans, including the United Mine Workers of America's, coming soon, Gotbaum said.

To provide partitioning, the PBGC must determine that a plan has taken all reasonable measures to avoid insolvency, including the maximum benefit suspensions; certify to Congress that the partition will not impair its ability to meet existing financial assistance obligations to other plans; and certify that the cost of the partition is paid exclusively from the agency's fund for basic benefits guaranteed for multiemployer plans.

''There's going to be a lot of work and focus for how we help plans, which is what we do through partition assistance in a way that does not impair our ability to help other plans that don't meet the requirements for partition and need to fall back on our guarantee,'' one of the PBGC officials said.

Cessation-of-Operations Enforcement. The budget bill also included a section that changed the conditions under which the PBGC can bring an enforcement action in cases involving a substantial cessation of an employer's operations under ERISA Section 4062(e).

Under 4062(e) as passed in 1974, if a company ceased operations at a facility that resulted in 20 percent of employees who are plan participants losing their jobs, the company would be treated as though it were subject to withdrawal liability on the termination of single-employer plans under multiple controlled groups.

After a lobbying campaign by business and retirement groups that said the PBGC's interpretation of the shutdown provisions was inconsistent with ERISA because under that approach, routine business transactions could trigger the 4062(e) liabilities, Congress redefined the liability trigger. It previously was a cessation of operations resulting in a workforce reduction of 20 percent of plan participants. Under the new law, now it's a cessation that results in a workforce reduction of more than 15 percent of all an employer's employees who are eligible to participate in its retirement plans. Further, the law requires that the shutdown be ''permanent'' (237 PBD, 12/11/14).

While Gotbaum praised Congress for amending ERISA on its cutback provisions, he called the 4062(e) redefinition a ''travesty.''

''In response to a few cases of excessive zeal in protecting workers' pensions, the response of Congress of the United States was to gut PBGC's ability to protect the pensions of workers who have lost their jobs in shutdowns,'' Gotbaum said.

While still director of the PBGC, Gotbaum had announced in July that the agency was imposing a moratorium on its enforcement program through the end of the year while it worked on developing nonregulatory guidance (132 PBD, 7/10/14).

There are still theoretically cases in which 4062(e) would apply, but ''the question is whether or not there are so few of them that it doesn't make sense for the PBGC to have an enforcement effort to find them,'' he said.

Others lauded Congress for its redefinition.

The legislation ''really establishes an excellent framework for moving forward and will address the concerns that the companies, the plan sponsors, have had with respect to this area,'' said Kent A. Mason, a partner with Davis & Harman LLP in Washington and outside counsel to the American Benefits Council.

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Constance Donovan, the participant and plan sponsor advocate at the PBGC, agreed with Mason, and said that withdrawal liability will now be ''much more proportional'' to what it should be.

Prior to the change in the definition, the value of the liability that the PBGC might assess ''could far outweigh'' the value of the transaction that caused the 4062(e) event, she said.

''I think that PBGC was really getting into too much boardroom stuff,'' Donovan said.

Donovan, who has been in her newly created position for a year, issued her first report on agency operations at the end of 2014, saying the PBGC has several areas in which it can improve its operations, such as taking a less adversarial approach to its enforcement operations. The report said cessation-of-operations cases were one example of the agency's enforcement ''over-reaching'' (2 PBD, 1/5/15).

But the changes in the new law do still leave some questions, especially in terms of what ''permanent cessation of operations'' actually means, said Michael J. Prame, a principal at Groom Law Group Chartered and chairman of the firm's litigation practice group.

''Permanent'' may hinge on a facts-and-circumstances test, in which the plan trustees' decision to shut down a facility was based on what they were looking at the time of their decision, Prame said. If there is enough in the administrative record to support the conclusion that the shutdown was intended to be permanent, then it would be permanent under 4062(e) even if the facility were reopened, say, six months later, he said.

Prame said the PBGC had also asserted the position that it could apply a lien in connection with the liability and that he is waiting to see if the agency will continue to take that position.

''The good thing about the legislation is that there's greater clarity as to how to calculate when there's a reduction in the workforce,'' Prame said. Companies had been struggling with that calculation when deciding on actions such as moving operations within facilities or within the company, he said. Companies can now structure their transactions knowing what the potential liabilities can be, he said.

Harold J. Ashner, a partner in the law firm Keightley & Ashner LLP in Washington, who served as assistant general counsel for legislation and regulations at the PBGC from 1988 to 2005, also praised the revision, while adding a cautionary note.

''The good news for employers is that you now get to compare the number of separated employees to a much larger base when determining whether the liability trigger has been crossed. But it's important to keep in mind that you also may for this purpose have to take into account many more separated employees than you did under the old law. In other words, it's not just the denominator, but also the numerator, that could be a lot larger under the new law,'' he said.

PBGC officials said that the agency expects to release information within the first quarter of 2015 as to what the changes to 4062(e) mean going forward.

Early Warning Program. While Congress has curtailed some of the PBGC's 4062(e) enforcement strength, the agency officials said that they will continue to focus on their early warning program under ERISA Section 4042(a)(4), where they scored successes in 2014.

Under the program, in-house financial analysts monitor companies by reviewing company financial statements, government reports, actuarial valuations and public announcements of major transactions. The analysis helps the agency evaluate the risk of future plan terminations and identify transactions that may hurt plans and their participants.

The two early warning cases ''that are the most significant for the future of PBGC'' are *PBGC v. Saint-Gobain Corp. Benefits Comm.*, E.D. Pa., No. 2:13-cv-02069-MAM, *settlement announced* 4/16/14 (74 PBD, 4/17/14) and *PBGC v. Asahi Tec Corp.*, D.D.C., No. 1:10-cv-01936, *proposed settlement announced* 11/4/14) (214 PBD, 11/5/14), the officials said.

Under Section 4042(a)(4), the PBGC can move to terminate a financially troubled single-employer pension plan if not making that move might significantly increase the agency's long-term loss.

In the case involving Saint-Gobain Containers Inc., a Muncie, Ind.-based glass manufacturer, the PBGC sought to terminate the plan in April 2013, expressing concerns that Luxembourg-based Ardagh Group's acquisition of the company would leave it in the hands of a ''below investment grade company, potentially jeopardizing the future of the pension plan'' (76 PBD, 4/19/13).

The company resisted the agency's move, and the PBGC took Saint-Gobain to court. Under the settlement, Saint-Gobain's previous and new owners made $207.5 million in additional contributions to the pension plan—bringing the plan's funded status to about 80 percent, up from 63 percent in 2013.

Saint-Gobain was significant because it was the first time a case was brought under Section 4042(a)(4) to force a plan sponsor to fund up its plan, the officials said.

In *Asahi Tec*, the U.S. District Court for the District of Columbia ruled that the PBGC could hold Japan-based Asahi Tec Corp. liable under a controlled group theory for the unfunded pension benefits and termination premiums owed by a former U.S. subsidiary, Metaldyne Corp., which filed for bankruptcy protection in 2009 and has essentially gone out of business.

The PBGC's pursuit of the Japanese company ''put us square away against the idea of collecting against a foreign operator because Asahi Tec had no other U.S. assets,'' one of the agency officials said. After a protracted legal battle, the agency settled for $39.5 million against the risk of not collecting in another protracted legal battle in Japan, one of the officials said.

The upshot of the case is that ''we protected 10,000 workers and retirees, and we set the precedent that a control group member in a foreign country is not immune. That's very significant for us. Actually, it's very significant for the U.S. government in general,'' one of the officials said.

Asked whether there were future enforcement possibilities under 4042(a)(4), one of the officials said, ''Yes, absolutely. It is one of the things we will look forward to potentially using in 2015.''

''You should expect to more early warning cases'' in 2015, one of the officials said.

Saint-Gobain is a case with which Prame, of Groom Law Group, is familiar, because his firm represented the container company, as well as two other companies whose pension plans the PBGC took over, in 2013 and

2014, Southfield, Mich.-based Metavation LLC and Revstone Casting Fairfield LLC.

Groom has also seen other merger and acquisitions situations in the past year in which the PBGC has attempted to get involved, Prame said.

The normal remedy for the PBGC in these M&A transactions is to put pressure on plan sponsors to take additional actions to fund up the plan or make sure contributions are made on a going-forward basis, Prame said.

''It's when those discussions or negotiations break down that the PBGC feels threatened, that they will initiate to terminate the plan in advance of the corporate transaction.''

Groom, in representing plan sponsors, contends that the PBGC is reaching an incorrect financial analysis in its efforts to determine whether it has a greater long-term risk due to M&A transactions, Prame said. The agency may be failing to take into account factors in connection with the transactions that don't materially increase the agency's long-term risk, he said.

Prame said that no early warning program/contested involuntary termination cases have been decided on the merits in court, so there aren't any decisions finding that the PBGC failed to make its case. Pointing to the Saint-Gobain case as an example, he said ''the court decided that the PBGC's determination that a corporate transaction would increase the possible long-run loss to the agency was not entitled to judicial deference.''

''In other words,'' Prame said, ''the court would decide de novo whether there could be an unreasonable increase in PBGC's liability. As a result of this ruling, companies are in a better position to argue that the sale or spinoff of subsidiaries or other transactions that break up a controlled group will not unreasonably increase PBGC's liability—for example, by showing that the controlled group for the plan sponsor continues to have sufficient wherewithal to fund the plan.''

De-Risking. Another issue that will be on the PBGC's radar is pension plan de-risking, in which plans seek to lower the financial risks resulting from plan funding requirements. The issue picked up steam in 2014, with a number of companies settling their funding obligations through group annuity purchases from insurance companies or lump-sum distributions, the most controversial forms of de-risking.

De-risking through lump–sum distributions or annuity purchases—which the PBGC called ''risk transfer activities'' in a draft version of its premium filing instructions for 2015—has become a hot-button issue for the agency as well as for those who represent plan participants.

Premium payments and the investment income earned on them are a major source of income for the agency, so ''information about risk transfers is critical to PBGC's ability to assess its future financial condition,'' the agency said in an information collection request issued Jan. 9 (7 PBD, 1/12/15).

''This is clearly a pressure point for us,'' a PBGC official said, ''but the main point here is not what are the details of the instructions, it is that we think all parties are better served if there is actual good data on how many plans are doing this, and what specifically they're doing.''

In a survey by Prudential Financial Inc. in early 2014, about half of polled senior finance executives said their companies are at least somewhat likely to transfer their defined benefit plan liabilities to a third-party insurer in the next two years or to offer lump-sum distributions to plan participants (130 PBD, 7/8/14).

Prudential—the second-largest U.S. life insurer—has also been taking on high-dollar pension obligations since 2012 for companies such as Motorola Solutions Inc., Bristol-Myers Squibb Co., General Motors Co., Visteon Corp. and Verizon Communications Inc., as well as some U.K. pension plans (191 PBD, 10/2/14).

Transactions such as Motorola's, and TRW Automotive Holdings Corp.'s transfer of its U.S. pension obligations to MetLife Inc. (241 PBD, 12/17/14), means that the PBGC has put termination audits ''high on our list'' for 2015, an agency official said.

A complete plan termination—not just offering lump sums or annuities to some employees—triggers a termination audit requirement, the officials. ''And very often, we find difficulties in the calculation of benefits, and misinterpretations of very complicated documents,'' one of the PBGC officials said.

Benefits and Drawbacks of Annuities. Not all commentators said that risk shifting—at least for insured annuities—is a bad idea. Giving responsibility to insurers puts the pension system ''in a place where it makes much more sense for it to be,'' Gotbaum said.

''Most employers have made it clear that they are unwilling to assume the risks of traditional pensions,'' Gotbaum said. ''So, if you want to have traditional pensions with lifetime income, you have to have institutions that are willing to take that risk. Guess what? That's insurance companies.''

But several questions remain about annuity purchases, said Ferguson and Friedman of the Pension Rights Center.

''The real question is whether Prudential is taking on too much liability in doing this,'' Friedman said. Annuities purchases are also ''just one more situation where companies are balancing the books on the backs of retirees,'' she said.

Ferguson and Friedman said that other concerns include how a less-experienced insurer than Prudential or MetLife handles a company's pension obligations; whether an insurer turns its liabilities into lump sums within a few years after the purchase; and how to replicate ERISA protections to the extent possible.

ERISA-like protections—such as the exemption for garnishments from pensions—vary by state, they said. In addition, once an insurer takes on annuity responsibilities, the annuity payout backstop shifts from the PBGC to the state guaranty associations in the event that an insurer becomes insolvent. And guarantee levels also vary by state, from a low of $100,000 (Massachusetts, New Hampshire and Puerto Rico) to a high of $500,000 (New Jersey and Washington), according to data the PRC collected from the National Organization of Life & Health Guaranty Associations.

But there are likely to be fewer annuity purchases in 2015, said Olivia S. Mitchell, executive director of the Pension Research Council at the University of Pennsylvania's Wharton School of Business.

Because the discount rate that would have to be used as of January to value the liability was lower at the close of 2014 than it was a year earlier, the cost of settling a sponsor's pension obligations through a buyout has increased, Mitchell said. Most of the companies that were

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thinking about an annuity buyout considered 2014 a good year for taking that step, she said.

"That's not to say it won't happen again in 2015, but there may have been a bump in the probability of that happening, which will decline."

Gotbaum and the Pension Rights Center disagreed on annuity purchases as a risk-shifting measure, but both said that lump-sum distributions are a poor option to give plan participants.

One of the low points, in fact, of 2014, was that "a depressing number of companies are de-risking by offering lump sums to their employees at a discount," Gotbaum said. "And more depressing, a substantial fraction of employees are taking the lump sums."

As a result, said Gotbaum, Ferguson and Friedman, people are leaving thousands of dollars, if not tens of thousands of dollars, in lifetime income on the table—an issue made more critical because many people lack the financial savvy to make their lump sums last through their retirement years.

But don't expect the lump-sum train to stop any time soon. Mitchell, who agreed with Gotbaum and the Pension Rights Center on the potential dangers of lump sums, said that such distributions "are perfectly legal and even condoned by pension law."

"For a lot of different reasons, I think this is something that companies will continue to offer," Mitchell said.

Living Longer. Yet another factor contributing toward the push toward de-risking is the Society of Actuaries' revised mortality tables, which surprised many by estimating that people would live even longer than they were prepared for (208 PBD, 10/28/14).

The tables are expected to increase liabilities by 6 percent to 9 percent for traditional ongoing pension plans (210 PBD, 10/30/14).

The SOA's mortality tables "are a major issue," said Mason, of Davis & Harman. So far, the tables are effective only for accounting purposes, but already "they are having a very adverse effect on plan sponsors and in many cases overestimating their liabilities," he said.

Results from a Towers Watson report on 2014 pension funding levels are already showing the effect of the new mortality tables. Funding levels dropped an average of 9 percentage points in 2014, largely reversing gains made in 2013, and Towers Watson cited the impact of the mortality tables as one of the reasons. The pension deficit more than doubled in 2014 to $343 billion, from $162 billion a year earlier—and about 40 percent of the increase was due to improvements in life expectancy as reflected in the tables, the consulting firm said (2 PBD, 1/5/15).

Mason said that due to the magnitude of the issue, and questions about the accuracy of the tables, groups will begin working early this year to start a dialogue with Treasury and the Internal Revenue Service, and with lawmakers in Congress, "about what can be done to correct what is a very unfortunate situation."

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