Understanding Pension Plan Withdrawal Liability

Jay K. Egelberg, ASA, FCA, MAAA, EA
Consulting Actuary
First Actuarial Consulting, Inc. (FACT)
New York, New York

James K Estabrook, Esq.
Shareholder
Lindabury, McCormick, Estabrook & Cooper, P.C.
Westfield, New Jersey

70TH ANNUAL EMPLOYEE BENEFITS CONFERENCE

International Foundation OF EMPLOYEE BENEFIT PLANS

Overview

- What is withdrawal liability?
- Determining withdrawal liability
- What triggers withdrawal liability?
- Exemptions to withdrawal liability
- Payment schedules
- Challenges to withdrawal liability

Withdrawal Liability: Sponsor Responsibility

- When an Employer withdraws from a multiemployer plan, the Trustees **shall**:
  - Determine amount of employer’s withdrawal liability
  - Notify Employer of amount of withdrawal liability
  - Collect withdrawal liability from the withdrawn Employer.

What Is Withdrawal Liability?

- Governing laws
  - ERISA = Employee Retirement Income Security Act of 1974
  - MPPAA = Multiemployer Pension Plan Amendments Act of 1980
- “Exit Fee” withdrawing employer must pay to Pension Fund
- Withdrawal liability is the employer’s proportionate share of the entire plan’s underfunding for vested benefits
  - amounts can be significant
- Withdrawal liability will be assessed on an employer whose obligation to contribute to the pension fund ceases
  - Even if employer never was delinquent in making CBA-required contributions

Determining Withdrawal Liability: 3 Steps

1. Actuary values pension fund
   - Compares present value of unfunded vest benefits against fund assets
   - Any shortfall in assets is unfunded vested benefits [UVBs]
2. Think of UVBS as a large pie to be divided among all contributing employers
   - Generally allocated based upon employer's contributions/ALL employers' contributions
3. Now that we know the withdrawn employer's "slice of the pie," how does employer pay it off?
   - ERISA requires quarterly payments
     - Plan sponsor may amend for different frequency
   - How many quarterly payments are required to pay allocation under 2 above?
     - ERISA imposes limit of 20 years [except for mass-withdrawal reallocation liability]

What Triggers Withdrawal Liability?

- Withdrawal may be <u>Complete</u> or <u>Partial</u> or <u>Mass</u>
- Complete withdrawal
  - Employer stops making contributions as a result of:
    - Collective bargaining
    - Stopping completely all operations covered under the plan
- Partial withdrawal
  - 70% decline in contribution base units [over a 3-year testing period]; or
  - Facility take-out [one or more but not all]; or
  - CBA take-out [one or more but not all]
- Mass withdrawal
  - Plan terminates by withdrawal of every employer; or
  - Substantially all employers withdraw from the plan

What Triggers Complete Withdrawal?

- Employer is bound by CBA to contribute for its bargaining-unit employees to a multiemployer pension plan, and then, for example:
  - Does not sign a new CBA upon expiration of the old CBA; or
  - Continues/renews CBA but has negotiated out of the pension plan; or
  - Shuts its doors and goes out of business; or
  - Liquidates its assets in bankruptcy; or
  - Sells its assets
    - Exemption if asset purchaser agrees to assume fund responsibilities
    - Exemption if sale of **stock**: Purchaser automatically assumes fund responsibilities

Exemptions for Complete Withdrawal

- Available for certain industries
  - Building and construction
  - Entertainment
  - Trucking/warehouse
- Exemptions recognize employees in these industries work on a project-by-project basis
  - Employer entities formed/disbanded project-by-project

Exemptions for Complete Withdrawal

- What constitutes “Building and Construction”?
  - NLRB has defined as “the provision of labor whereby materials and constituent parts may be combined on the building site to form, make, or build a structure”
  - Courts have held this cannot be delivering materials or manufacturing building materials
- No withdrawal occurs if ceases operations in the jurisdiction for 5 years or returns within 5 years and continues to contribute
- Exception *only* applies if “substantially all” of the employees work in the building and construction industry
  - Courts have interpreted this term to mean 85% or more
- It is up to the employer to prove they are eligible for exemption

Exemptions for Complete Withdrawal

- Entertainment-industry exemption very similar to Building-and-Construction exemption
- “Entertainment” generally applies to:
  - Theatre
  - Motion picture
  - Radio
  - Television
  - Sound or visual recording
  - Music
  - Dance
- Plan can be amended to deny exclusion to a group or class of employers

Exemptions for Complete Withdrawal

- No Withdrawal Liability if:
  - Substantially all fund contributions are made by employers primarily engaged in the Industry
  - Employer permanently ceases to have an obligation to contribute or permanently ceases all cover operations
  - Employer does not continue work in the jurisdiction.
- Trucking/warehouse, additional requirements apply:
  - PBGC can determine the plan has suffered substantial damage to its contribution base within 5 years of cessation
  - Employer must furnish a bond or amount in escrow to cover 50% of withdrawal liability at cessation

How Much Is Withdrawal Liability?

- Fund determines the plan year in which withdrawal is deemed to have occurred
- Based upon fund's actuarial/financial position as of last day of plan year prior to wdl.
- Fund actuary conducts valuation
  - Calculates present value of vested benefits
  - Compares to fund assets
  - Any shortfall = Present value of unfunded vested benefits [UVBs]
- Allocation of UVBs
  - 20-pool method is default
    - Mandated for building-and-construction funds
  - 1-pool method is popular, simpler
  - Fund may design its own direct-attribution method
- Typically, each year's UVB pool is allocated to the withdrawing employer via a fraction
  - Sum of **withdrawn employer's** contributions for the prior 5 plan years
  - Sum of **all employers'** contributions for the prior 5 plan years

Reductions to Withdrawal Liability

- *De minimis* rules for administrative ease [ERISA 4209]
  - IF fund UVBs > $6.667M
    - THEN automatic $50,000 reduction in allocation to employer
  - IF fund UVBs < $6.667M
    - THEN automatic reduction in allocation to employer = 0.75% of UVBs
  - IF UVBS allocated to employer > $100,000
    - THEN this reduction is further reduced dollar-for-dollar over $100,000
- Above rule is mandatory
  - Prevents fund from collecting from small employers
    - What if all employers are small?
- Plan sponsor may amend these rules
  - $50,000 → $100,000
  - $100,000 → $150,000
  - Further administrative ease, but the fund collects less

Reductions to Withdrawal Liability

- Free-look rule [ERISA 4210]
  - Optional: To entice new employers?
  - Requires plan sponsor action to adopt
- NO complete/partial withdrawal liability IFF employer
  - First contributed after 1979 enactment of MPPAA
  - Had obligation to contribute for no more years than fund requires for vesting
    - Generally, 5 years
      - Typically, duration of one collective-bargaining agreement
  - For each such plan year, contributed < 2% of all employers' contributions for each such plan year

Partial Withdrawal Liability

- ERISA has rules under which a partial cessation of obligation to contribute could trigger liability
- To ensure that employers' gradual reduction of fund contributions do not escape withdrawal liability
- Obligation to contribute ceases only partially:
  - 70% decline in contribution base units; or
  - CBA take-out; or
  - Facility take-out

Partial Withdrawal Liability—Exemption

- **Retail-food industry**
- Regarding 70% reduction in contribution base units
- Plan sponsor has option to adopt
- Measure for 35% reduction [instead of 70%]
  - Easier for an employer to trigger partial withdrawal liability
- Doesn't affect other partial withdrawal liability
  - CBA takeout
  - Facility takeout

Partial Withdrawal Liability—Calculation

- Determine standard complete liability
- Apply fraction = 1 – (A)/(B)
  - A = Employer's contribution base units in plan year following partial withdrawal*
  - B = Average of employer's contribution base units in 5 plan years before plan year of partial withdrawal
- Minor modifications if partial caused by 70% decline
- *Will not be able to assess until contribution base units are tallied after end of the next plan year
- Employer may experience a series of partial wdls.

Mass Withdrawal Liability

- Plan terminates by withdrawal of every employer; or
- Substantially all employers withdraw from the plan pursuant to an arrangement or agreement
- Employers who withdrew during the 3 plan years prior to mass withdrawal are presumed to be part of such arrangement/agreement and are treated as if they had withdrawn in a mass withdrawal
  - Employer may attempt to prove other “by a preponderance of the evidence”

Mass Withdrawal Liability

- Many actions required of plan sponsor
  - Declarations of several dates
  - Notices to PBGC and employers
  - Test for pending insolvency
    - May have to limit benefits to PBGC guarantees
  - Demands for three types of withdrawal liability
    - Initial
    - Redetermination
    - Reallocation

Mass Withdrawal Liability

- Initial withdrawal liability
  - As if for standard complete withdrawal
- Redetermination liability
  - Removal of 20-year cap
  - Removal of *de minimis* exemptions
  - Removal of free-look exemption
- Reallocation liability
  - Fund must use PBGC assumptions
    - Interest, mortality, expenses, expected retirement age
  - Employers pay for other employers deemed unable to pay
    - Plan sponsor must determine collectability of liability from all employers
  - Exposure: All current + employers withdrawn in prior 2 plan years

Collection of Withdrawal Liability: Payment Schedule

- First calculate required annual payment = X * Y
- X = highest contribution rate in the last ten plan years, including plan year of withdrawal
  - Special rules for rehabilitation-plan contributions
- Y = highest 3-year average of employer's contribution base units
- Now, how many years will it take for that payment to satisfy the UVBs allocated to that employer?

Collection of Withdrawal Liability: Payment Schedule

- Think of this as a loan
- A loan has 4 elements
  - Outstanding balance of loan = Allocated UVBs
  - Periodic payment = Required annual payment
  - Interest rate per year
  - Number of years [to be determined now]
    - Remember logarithms from high school?

Collection of Withdrawal Liability: Payment Schedule

- What happens if number of years > 20?
- Nominal withdrawal liability
  - = “Slice of pie”
- Effective withdrawal liability
  - = Present value of 20 years of payments
  - – Really, 80 quarters of payments

Collection of Withdrawal Liability: Payment Schedule

- ERISA
  - "...shall be payable quarterly..."
    - Vast majority of pension funds
  - "...or at other intervals specified by plan rules."
    - Monthly is popular
- Interest is due on late payments
  - Accrues from date due until date paid
- Employer may pre-pay, in whole or in part

Collection of Withdrawal Liability: Payment Schedule

- Employer may pre-pay, in whole or in part
- Employers often offer lump-sum payments to extinguish the debt
  - Trustees have discretion to accept less than the full present value of remaining payments owed
  - Trustees consider:
    - “Bird in hand”
    - Viability/strength/creditworthiness of withdrawn employer
    - Accepting % of present value owed
    - Determining present value assuming different interest rate

Collection of Withdrawal Liability: Payment Schedule Under MASS WITHDRAWAL

- Payment period might be infinite
- Even though plan could be terminated:
  - Trustees must continue to:
    - Administer
    - Pay benefits
    - Manage investments
    - Collect withdrawal liability
      - Payments of withdrawal liability could cease at end of plan year in which plan assets [excluding receivables] > plan obligations
        - » PBGC will decide

How Much Is My Withdrawal Liability? Can I Get an Estimate?

- Upon employer's written request, pension fund furnishes notice of estimated withdrawal liability
  - As if employer withdrew on last day of plan year preceding date of request; and
  - Explanation of how estimate was determined
    - Actuarial assumptions and methods used
    - Employer's contribution data regarding
    - Annual changes in plan's unfunded vested benefits
    - Application of any relevant limitations/exemptions

How Much Is My Withdrawal Liability? Can I Get an Estimate?

- Compliance
  - Within 180 days after employer's request
  - Provided in written, electronic, or other appropriate form reasonably accessible by requesting employer
  - No more than once during any one 12-month period
  - May make a reasonable charge to cover copying, mailing, and other costs of furnishing such estimate
- What's missing?
  - Payment schedule
  - Estimate for withdrawal during current plan year

Withdrawal Liability Disputes

- Most employers unhappy about assessment/ demand
- <u>Must</u> begin to make periodic payments upon demand by pension fund
- Disputes are possible
  - Must be resolved via arbitration
- <u>Must</u> continue to make periodic payments during dispute procedure

Withdrawal Liability Disputes

- Pension fund's assessment is presumed correct
  - Challenger must show, "by a preponderance of the evidence," that determination of withdrawal liability was:
    - Unreasonable; or
    - Clearly erroneous
  - To challenge determination of UVBs, must show, "by a preponderance of the evidence," that:
    - Actuarial assumptions and methods were, in the aggregate, unreasonable (taking into account the experience of the plan and reasonable expectations); or
    - The actuary made a significant error in applying actuarial assumptions and methods

Evade / Avoid?

- If a ***principal purpose*** of any transaction by a withdrawing ER is to evade or avoid liability, then the transaction is disregarded and withdrawal liability is collected without regard to such transaction.
- Types of transactions that are typically scrutinized include:
  - Sale of a business
  - Grant of a security interest to secure pre-existing shareholder loans
  - Distributions to shareholders when the prospects of a withdrawal are foreseeable.
  - Transfer of assets to a corporate retirement trust
  - Incorporation of an unincorporated entity on the eve of a withdrawal
  - Transfers of stock on the eve of a withdrawal to avoid controlled-group minimum-ownership standards.

Key Takeaways

- Withdrawal liability is complicated and technical
  - Depend upon your:
    - Actuary
    - Administrator
    - Attorney.
- Trustees have responsibility to demand, collect

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