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Management Alert

Pension Act Affects Contributors to Multiemployer Plans

Congress has made sweeping changes to the requirements for employer-sponsored retirement plans in passing the Pension Protection Act of 2006 (PPA). Although many of the new requirements under the PPA focus on single employer corporate plans, the legislation also seriously impacts the administration of multiemployer plans. These PPA changes will directly affect employers who contribute to multiemployer plans (including the possibility of (a) changes in the collective bargaining process and (b) increased contributions over what is required in the employer's collective bargaining agreement). It is therefore critical for employers to monitor the funded status of any multiemployer plan to which they contribute. This Alert will focus only on those aspects of the new law that could affect employer participation in multiemployer plans.

Multiemployer Plans Entering "Endangered" or "Critical Status"

The PPA establishes new classifications for multiemployer plans that do not meet certain funding criteria - "endangered" and "critical status" plans. The PPA contains very specific definitions for what constitutes an "endangered" plan or a "critical status" plan. In general, however, plans that are somewhat underfunded (e.g., plans that are less than 80 percent funded or have projected a funding deficiency within seven years) are considered "endangered," and plans that are more severely underfunded (e.g., plans that are less than 65 percent funded and have projected a funding deficiency within five years or the inability to pay benefits within seven years)[1] are considered "critical."

Once a multiemployer plan is considered to be "endangered" or "critical," the trustees of the plan are required to come up with an action plan that is designed to improve the funded status of the plan over time. As part of the process of devising the action plan, the trustees must provide the bargaining parties with proposed funding "schedules" showing proposed benefit structures, contribution structures, or both, which would improve the funding status of the plan. One schedule, called the "default schedule," must propose a reduction in future benefit accruals under the plan to a level necessary to achieve certain funding improvement benchmarks for endangered plans, or to a level necessary to emerge the plan

[1]There are other ways in which a plan could be considered in "critical status", including if the plan projects a funding deficiency within four years or an inability to pay benefits within five years, regardless of funded percentage, or benefits for inactives are greater than for actives, contributions are less than carrying costs and the plan expects a funding deficiency within five years.

from critical status (with increases in contributions permitted only as necessary to meet the goal of the action plan). The trustees of an endangered plan must also propose a second schedule which provides for contribution increases in the amounts necessary to maintain the current benefit accrual rates under the plan. The trustees are also permitted to propose as many other schedules as they desire. If the bargaining parties do not implement any of the proposed schedules provided by the trustees within 180 days after the expiration date of the then current collective bargaining agreement (or upon impasse, if earlier), the trustees are required to implement the default schedule.

While the plan is considered "endangered" or "critical," the trustees may not accept a collective bargaining agreement that provides for a reduction in the level of contributions for any participants, a suspension of contributions with respect to any period of service, or any new direct or indirect exclusion of younger or newly hired employees from plan participation. Also, endangered and critical status plans may not be amended so as to increase benefits, including future benefit accruals, unless the plan actuary certifies that the benefit increase is consistent with the action plan. This means that unions and employers will be restricted in the types of changes they can negotiate during the bargaining process with regard to pension plan contribution and benefit increases if the plan is considered "endangered" or "critical."

Employers that contribute to endangered or critical status plans should also be aware that a new excise tax will be imposed upon the failure to make timely contributions required by an action plan. The amount of tax is equal to the amount of the required contribution the employer failed to make in a timely manner, and is in addition to all other excise taxes, penalties, or damages assessed for delinquent contributions (except that the current rules that assess excise tax against employers who contribute to plans with accumulated funding deficiencies will not apply to employers who contribute to critical status plans). The IRS may waive all or part of the excise tax on employers when there is reasonable cause and not willful neglect.

In addition, and most important, if an employer contributes to a plan that is in "critical" status, the employer is obligated to pay a surcharge contribution. This surcharge is equal to five percent of contributions otherwise required under the applicable collective bargaining agreement in the first year that the plan is considered to be in "critical" status, and ten percent for each "critical" year thereafter. Since the surcharge is meant to work as an incentive for the bargaining parties to reach agreement, the surcharge will terminate once the bargaining parties negotiate an acceptable contribution rate based on the proposed schedules provided by the trustees. The surcharge shall not apply to an employer until 30 days after the employer has been notified by the trustees that the plan is in critical status and that the surcharge is in effect. Any failure to make a surcharge payment will be treated as a delinquent contribution.

Additional Disclosure Requirements

The PPA adds significant new disclosure requirements for multiemployer plans. For example, plans will be required to issue funding notices to all participants regarding the plan's funded status, its funding policy and asset allocations, and the number of inactive and active employees. Also, certain additional notice requirements are triggered if a plan is or is expected to be in endangered or critical status. In addition, the law adds a requirement to provide, upon request, actuarial and financial reports to participants, employers, and unions.

Deductibility Limit

The PPA also increases the deduction limits for multiemployer plans from 100 percent to 140 percent of current liability.

Withdrawal Liability

The PPA makes only slight modifications to the withdrawal liability rules. For example, under the law, small, short-term contributing employers in the building and construction

industry are now exempt from withdrawal liability. Plans (including ones which primarily cover employees in the building and construction industry) may also be amended to restart the presumptive allocation method whenever its unfunded vested liabilities reach zero. The PPA also imposes partial withdrawal liability upon employers that contract work out to entities it owns or controls that have no obligation to contribute to the plan.

Minimum Funding Standards

The PPA shortens the amortization period from 30 years to 15 years for most increases or decreases in past service liabilities arising from plan amendments, changes in actuarial assumptions, and general gains and losses. Any amounts amortized over any period beginning with a plan year beginning before 2008, shall continue to be amortized under the current rules. In general, this change will increase the "cost" of funding plan amendments.

Interaction Between Moody's Analytical Approach and PPA

The PPA does not directly address Moody's recently announced ratings methodology which take into account an employer's participation in underfunded multiemployer plans. The PPA focuses new attention on this issue, however, and changes the impact of multiemployer plan underfunding on contributing employers. We will be monitoring Moody's closely to see if there are any changes in its ratings approach.

Practical Considerations and Conclusions

Given the possibility that employers that participate in multiemployer funds can face significant additional surcharges beyond what is required by their collective bargaining agreement in the event the plan falls into critical status, contributing employers may wish to negotiate provisions in their contracts that either permit them to reduce other wages or benefits accordingly to pay for the added charges, or at least that permit them to reopen the contract in the event such surcharges are imposed. Participating employers should also take a more active interest in how their multiemployer plans are run, so as to avoid the possibility of their fund falling into endangered or critical status. Finally, employers who are presented with proposals to participate in multiemployer funds must carefully assess the potential costs and risks beyond negotiated contributions, such as potential surcharges, withdrawal liability, and the penalties for delinquent payments.

Also, because the legislation is very broadly drafted in terms of the relationship between the administration of the plan by trustees and the obligation of the bargaining parties to negotiate over plan benefits and funding, it is unclear how certain provisions in the law will be interpreted, and how those provisions ultimately might impact the bargaining parties. We believe many of these issues ultimately will need to be clarified via regulations issued by DOL or IRS, or by court decisions.

If you have any questions regarding Multiemployer Plans, please contact the Seyfarth Shaw attorney with whom you work, or any of the Employee Benefits attorneys on our website, www.seyfarth.com.

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