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Multiemployer Review

Update on issues affecting multiemployer plans

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Failing to meet benchmarks by the end of a funding improvement or rehabilitation period

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Introduction

Many multiemployer pension plan trustees and advisers are familiar with the potential penalties in the form of excise taxes and surcharges associated with untimely adoption of a funding improvement plan (FIP) or rehabilitation plan (RP) for plans in endangered or critical status. Those who have worked with critical status plans are also probably aware that a failure to meet "scheduled progress" under an RP for three consecutive years can result in excise taxes. However, many may be less familiar with rules providing potential excise taxes and/or civil fines for failing to meet the FIP's or RP's goals by the end of the prescribed period. This could be a new and sudden reality for some plans due to the impact of the coronavirus on the stock market and employment levels. This article addresses the potential penalties if a plan reaches the end of its FIP or RP period and falls short of its goals.

Background

Similar to the passing of the Employee Retirement Income Security Act of 1974 (ERISA), the Pension Protection Act of 2006 (PPA) was the beginning of a new era in defined benefit plans. It changed the rules governing multiemployer pension plans and created new urgency to recognize and solve funding issues. One of the most notable and important changes was the introduction of the annual status certification. Multiemployer plans are certified annually by the actuary to be in a status based on various funding metrics. Plans certified as endangered, seriously endangered,[1] critical, or critical and declining statuses are required to introduce a FIP or RP to fix their funding issues over a 10- to 15-year period. Plans certified as not in any of those four statuses are considered to be in the "green" zone or "safe" status.

Soon after the enactment of PPA, many plans were certified to be non-green due to the market downturn experienced from 2008 to 2009. Trustees of these plans had to make difficult decisions to comply with PPA. FIPs and RPs typically required contribution rate increases, benefit reductions, or a combination of both.

[1] Seriously endangered plans use slightly different rules than endangered plans, but for purposes of this exposition they will not be detailed.

Once the FIP/RP period begins, the plan sponsor is required to annually review the FIP/RP and update it if necessary. There could be a wide range of reasons for needing an update, many of which are outside of the control of the plan sponsor, including lower investment returns and/or contributions than expected. The fund actuary is also required to certify annually whether the plan is meeting scheduled progress under the FIP or RP.

For some plans, the changes made by the FIP/RP combined with the strong economy in the past decade eliminated their need for a FIP/RP, while other plans continue to operate under their original FIP/RP. Those in the second category are likely nearing the end of their FIP/RP period.

So what happens at the end? What happens if the coronavirus causes a market or economy meltdown? Is there anyone coming to save the day? Over the next few paragraphs, we discuss the penalties of failure, potential guidance that may be coming, and ultimately what we will all need to be prepared to face.

Potential penalties for critical status plans

The legislation is clear on critical status plans. Under U.S. Code § 4971(g)(3), the plan must not fail to meet scheduled progress under the RP for three consecutive years nor fail to emerge from critical status by the end of the RP's period. However, in the face of poor experience, a plan in critical status has the ability to change its RP's target by adopting an "all reasonable measures" RP. A plan with an all reasonable measures RP is generally viewed as meeting the scheduled progress requirement as long as it has taken all action required by the RP. However, adopting an all reasonable measures RP often indicates a pension plan is heading towards insolvency or critical and declining status, and as the name suggests, requires that the Trustees have exhausted all reasonable measures to emerge from critical status on schedule (which could involve further contribution increases and/or reductions to "adjustable benefits" not part of the original RP).

For all other critical plans not projected to emerge from critical status by the end of the period, there could be cause for concern. Excise taxes could be levied on employers. The amount of such excise tax would be equal to the greater of the amount of contributions necessary to emerge from critical status/meet scheduled progress or the amount of the accumulated funding deficiency; excise tax could be waived depending on the reason for failure. Reasonable causes for failure include unanticipated and material market fluctuations, the loss of a significant contributing employer, or other factors (possibly such as COVID-19 in 2020).

Potential penalties for endangered status plans

In contrast to critical status plans, the legislation on endangered status plans is less clear. While a seriously endangered plan that does not meet its benchmarks by the end of its funding improvement period is subject to the same excise taxes as those for critical plans described above, U.S. Code § 4971(g)(3) does not discuss penalties for endangered status plans that fail to meet their benchmarks. However, regulators tried to resolve this issue by allowing for civil penalties in this situation.

For endangered status plans, scheduled progress is monitored and reported on the plan's Schedule MB of the Form 5500 filed with the IRS each year. While there is no penalty for not maintaining scheduled progress throughout the FIP's period as there is with an RP, Section 502(c)(8) allows for a civil penalty assessed to the plan sponsor of up to $1,100[2] per day (indexed for inflation) for failure to meet the applicable benchmarks by the end of the period. Similar to the excise taxes for critical or seriously endangered plans, these civil penalty could be waived depending on reason for failure.[3] For example, if the Department of Labor (DOL) determines that a pension plan and its trustees/employers have followed the agreed upon changes put forth in the FIP, they may reduce or waive the civil penalties.

[2] $1,402 per day for 2020

[3] Reasonable cause includes unanticipated and material market fluctuations, the loss of a significant contributing employer, or other factors.

Potential guidance

On November 13, 2019, there was an Intersector Group meeting[4] between the IRS and the Department of Treasury where many situations were discussed. Among those situations, they discussed multiemployer pension plans in endangered and critical status coming to the end of their FIP's or RP's period.

The group had previously discussed excise taxes for critical plans at the end of the RP period, and there seemed to be agreement that a technical correction was needed to handle the general situation. A technical correction is a provision available for the IRS to make generally noncontroversial changes to existing legislation to ensure that the law as enacted is consistent with Congress's original intent.

The group discussed plans that were meeting scheduled progress throughout the improvement period, but are ultimately unable to emerge by the end of the FIP or RP period because of unfavorable experience near the end of the period. The IRS/Treasury said that a statutory correction is needed instead of a technical correction to address this situation, and that there is no room for interpretation without more legislation.

In early 2020, the COVID-19 pandemic derailed the market and economy. As a result, it is likely that some multiemployer pension plans that were successfully approaching the end of their FIP or RP will not meet their targets. The IRS expects for cases to begin to happen, and is monitoring the situation.

Conclusion

The reality is the tumultuous market and economy experienced so far in 2020 may extend into the future. There could be legislation providing relief to multiemployer plans, but nothing is guaranteed at the moment. As a past manager of mine would say, hope is not a strategy. Applying that wisdom to this situation, it would be unwise to base a pension plan's strategy solely on hope for a market rebound and/or legislative relief. Trustees and professionals who manage plans in non-green status need to start planning ahead if their FIP or RP no longer meets the standards set by PPA. They must be prepared and nimble enough to adopt (revise) a new FIP or RP before any penalties or excise taxes could be levied or use the option to apply for a waiver in either situation. Of course, the first step in addressing these issues is becoming aware of them before it is too late.

[4] A caveat from the report: These meeting notes are not official statements of the IRS or Treasury and have not been reviewed by its representatives who attended the meeting. The notes are a reflection of the Intersector Group's understanding of the views expressed by IRS and Treasury representatives and do not represent the positions of the IRS, Treasury, or of any other governmental agency and cannot be relied upon by any person for any purpose. Moreover, the IRS and Treasury have not in any way approved these notes or reviewed them to determine whether the statements herein are accurate or complete. Retrieved on June 1, 2020, from https://www.ccactuaries.org/Portals/0/pdf/Intersector/Intersector-IRS-2019-11-13.pdf

FIGURE 1: PENALTIES FOR FAILURE TO MEET REQUIREMENTS FOR PLANS IN NON-GREEN ZONE STATUS

Zone status	Condition	Excise taxes imposed on employers	Civil penalties imposed on pension plan sponsor	Code sections
Endangered plans/ Funding improvement plan	Fail to meet the FIP's benchmarks by the end of the funding improvement period	N/A	Not to exceed $1,100 per day (adjusted for inflation)**; plan sponsor could request the penalty to not be assessed or be reduced	ERISA Regulations Section 502(c)(8)(a)(ii)
Seriously endangered plans/Funding improvement plan	Fail to meet the FIP's benchmarks by the end of the funding improvement period	An amount equal to greater of the amount of contributions necessary to meet FIP's benchmarks or the amount of the accumulated funding deficiency; excise tax could be waived depending on reason for failure*	N/A	26 U.S. Code § 4971(g)(3)
Critical plans/ Rehabilitation plan	Fail to emerge from critical status by the end of the rehabilitation period, or fail to make "scheduled progress" under rehabilitation plan for three consecutive plan years	An amount equal to greater of the amount of contributions necessary to emerge from critical status/meet scheduled progress or the amount of the accumulated funding deficiency; excise tax could be waived depending on reason for failure*	N/A	26 U.S. Code § 4971(g)(3)

*Reasonable cause includes unanticipated and material market fluctuations, the loss of a significant contributing employer, or other factors

**$1,402 per day for 2020

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