As trustees of multiemployer retirement plans look to the future and try to make sure members have adequate retirement income, a difficult 2009 continues to haunt them. The author points to three key issues trustees may have to decide: whether to allow loans and hardship withdrawals, whether defined contribution plans should be deferred to bolster other benefit plans, and how to deal with the looming problem of retirement income adequacy.

Heating or Eating?

Difficult Choices for Trustees of Multiemployer Retirement Plans

by David B. Brenner

©2010 International Foundation of Employee Benefit Plans

It is no secret that 2009 has been a tough year for the boards of trustees of multiemployer retirement plans. They are being forced to make difficult choices about loans and hardship withdrawals, deferring defined contribution (DC) plan contributions to bolster other troubled benefit programs and more. On top of this, they still need to remember that their primary responsibility is looking to the future, and helping members deal with the looming problem of retirement income adequacy. Many thorny choices have been made. Even more issues will require action in the months ahead as most boards of trustees continue to address three key questions.

1. Should We Allow Participants to Take Out Loans and Make Hardship Withdrawals?

A year ago, when we conducted the *Segal Study of Multiem-*

ployer Defined Contribution Plans,[1] only 35% of respondents offered hardship withdrawal provisions and 31% permitted loans. Since then, many boards of trustee-directed DC plans have begun to reconsider these policies in light of the severity of participants' economic problems.

Under the Internal Revenue Code (IRC), money purchase pension plans (38% of the plans in the Segal survey) are prevented from making in-service distributions including hardship withdrawals, although they are allowed to make in-service distributions if participants are aged 62, and they are allowed to have loan provisions.

Profit-sharing plans (62% of plans in the Segal survey) are permitted to allow in-service distributions as well as loans. In addition, 401(k) plan accumulations attributable to pretax employee contributions may also be withdrawn in case of hardship by someone still working for contributing employers. In addition, profit-sharing plans may permit in-service distributions of employer contributions for any reason, provided the money is in the account for at least two years, and the participant has participated in the plan for at least five years or has reached a stated age, which may be as young as 55.

The IRC's list of hardships eligible for safe harbor distributions includes medical expenses, costs related to the purchase of a primary residence or to prevent eviction, certain educational expenses, funeral expenses and certain expenses related to repairing damage to the participant's primary residence. A safe harbor distribution must be driven by an immediate and heavy financial hardship, which places a burden on plan sponsors to evaluate the hardship based on the facts and circumstances. The distribution may not exceed the amount of the need, which may include any federal, state or local income taxes or penalties. In addition, hardship distributions are includable in gross income and may be subject to federal income tax, including additional taxes on early distributions. Hardship distributions are not paid back to the plan.

Although profit-sharing and money purchase plan loans are generally permitted, they are limited to the lesser of $50,000 or 50% of the vested account balance. A participant may have more than one outstanding loan from the plan at a time. However, any new loan, when added to the outstanding balance of all of the participant's loans from the plan, cannot be more than the plan maximum amount. In determining the plan maximum amount, the $50,000 is reduced by the difference between the highest outstanding balance of all of the participant's loans during the 12-month period ending on the day before the new loan and the outstanding balance of the participant's loans from the plan on the date of the new loan.

It is a rare board of trustees that is willing to enter into the business of holding a note securing a participant's property, especially for participants who are likely to be financially challenged to begin with.

Plans also are restricted from allowing loans to participants who have previously defaulted on a loan, which is considered a deemed distribution subject to federal income tax and possibly an early withdrawal excise tax. Participants with deemed distributions are prevented from additional loans unless the new loan is secured or subject to payroll deduction or the old loan is repaid with interest.

Loans create administrative challenges, especially in situations when—as is typical with multiemployer plans—payroll deduction is not an option for the repayment of the loan. It is a rare board of trustees that is willing to enter into the business of holding a note securing a participant's property, especially for participants who are likely to be financially challenged to begin with.

Since profit-sharing plans have more liberal rules regarding in-service distributions, some plan sponsors have considered converting their money purchase plans to profit-sharing plans. However, the administrative issues related to a conversion may stymie the desired results of giving financially strapped members access to their account balances without incurring tax penalties or impinging upon future retirement savings.

Both the Department of Labor and the IRS have determined—and IRC §204(h) regulations state—that the conversion of a plan from a money purchase plan to a profit-sharing plan requires a notice to plan participants about a cutback in benefits. The basis for this viewpoint is that because determinable contributions under a money purchase plan are no longer guaranteed under a profit-sharing plan, there could potentially be a cutback in benefits to participants in the future. The §204(h) regulation requires that a notice must be distributed to participants no later than 15 days before the effective date of the plan amendment.

An additional frustration to boards of trustees seeking to provide immediate relief to financially distressed members is that the money in the account balances must be accounted for separately until it is distributed to the participant. Contributions made prior to the conversion of the money purchase plan to a profit-sharing plan would remain subject to the money purchase in-service distribution rules, including the qualified joint-and-survivor annuity provision as a protected benefit. Regardless of the trustees' intention to take advantage of the in-service distribution rules of profit-sharing plans, the plan is still required to maintain separate accounting for the contributions made before the conversion, all earnings for the contributions made after the conversion and the earnings attributable to those contributions. While the accounts may be pooled and invested together, they must be accounted for separately until distributed to the participant, adding another hurdle to the change.

From the perspective that these account balances represent future retirement savings, the limitations imposed on in-service distributions make complete sense. However, for individuals facing serious financial challenges of bankruptcy, foreclosure or eviction, meeting the needs of today overshadows rational planning for the future.

Considering the complexity of and lim-

Continued on next page

itations on in-service distributions, the focus thereby shifts to how quickly an unemployed participant will be considered separated from service and then eligible for a distribution. In a multiemployer setting, it is not always easy to tell when an individual has stopped working and has truly separated from employment.

Trustees should consider what is reasonable within the industry in which their participants are employed. Increasingly, boards are being asked to consider periods as short as three months of not working in covered employment as a separation. However, trustees should be concerned that shortening the separation of service rules is not considered a subterfuge for in-service distributions, a matter that should be reviewed with legal counsel.

Plan sponsors may also want to consider providing the "three-month or six-month" provision for a limited time. (If not, it would be difficult to go back to the 12-month rule without having cutback issues if the plan is a money purchase plan.) That said, legal counsel's input is important in helping the board reach any decisions in this area.

2. Should We Defer DC Plan Contributions to Bolster Other Troubled Benefit Programs?

An overwhelming majority of the DC plans in the Segal study (82%) are companions to defined benefit (DB) plans sponsored by the same unions and contributing employers for the same workers. Over the past year, some boards have started redirecting contributions that would have gone to their DC plans to improve the funding of companion DB plans and, in some cases, related health plans. This trend is likely to continue at least until the employment rate starts to improve and overall economic markets recover.

With the passage of the Pension Protection Act of 2006 (PPA), Congress sought to impose a discipline on DB plans by requiring plan sponsors to review actuarial projections of the financial status of multiemployer plans to identify emerging funding challenges so they can be addressed. Plans are classified as either in *endangered status* (nicknamed the "yellow" zone), in *critical status* ("red" zone) or *neither endangered nor critical* ("green" zone). Trustees of yellow and red zone plans are required to take specific actions to improve the DB plan's financial status.

In the spring of 2008, The Segal Company published a *Survey of Calendar-Year Plan's Actual Zone Status*. It reported that 83% of plans in the survey were in the green zone. Fast forward to the fall of 2008 as the historic market meltdown turned the DB world on its head. As it would later emerge in a followup Segal survey in the spring of 2009, the percentage of green zone calendar-year plans declined from 83% to 39% while yellow zone plans increased from 10% to 29% and red zone plans increased from 7% to 32%.

Fortunately, multiemployer DB plan sponsors were provided with short-term, limited funding relief with the passage of the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA). Among the provisions in the legislation was the opportunity to elect a one-year freeze in zone status, allowing plan sponsors a brief respite from funding problems that would otherwise have required hard-to-implement updates to funding improvement plans and rehabilitation plans as well as possible excise taxes and penalties on contributing employers.

It was hoped that this "time out" would give the plans a breathing period during which the market would recover to some degree and their boards could explore other funding options. Over the past few months, many plan sponsors have taken steps to address their DB plan's funding problems by shifting contributions from their DC plans to their DB plans. Deferring money from DB plan contributions, however, raises a number of questions. Key among them: What are the best vehicles for assuring retirement income adequacy?

3. What Steps Should We Take to Help Members Deal With the Looming Problem of Retirement Income Adequacy?

When a board decides to reduce or defer DC plan contributions, it obviously limits that plan's ability to grow. Not contributing when the market is low will reduce potential earnings. Initially, most multiemployer DC plans were intended to be ancillary to DB plans. Cuts in contributions to DC plans may eventually affect when and how employees will be able to retire, but perhaps more importantly, will also force plan sponsors to choose between DC plans and DB plans.

If any good has come out of the recent market meltdown, it is the fact that it resuscitated the recognition of the value of the retirement security provided by DB plans. As plan participants watched their DC plan account balances decline, it arguably served to increase the resolve of boards and plan participants in protecting DB plans, even if it was, in some cases, at the expense of future contributions to their DC plans. Rather than following the lead of the single employer world, which has largely abandoned DB plans in favor of DC plans, multiemployer plan sponsors are able to offer greater certainty of retirement adequacy with the core determinable benefits of the DB plan.

As a final note, boards need to communicate with participants about what the current economic environment means relative to their DC plan and the companion DB plan. An opportunity exists as plan sponsors comply with PPA requirements to issue benefit statements to create statements that also serve as meaningful retirement planning tools that educate participants, promote needed changes in participant behavior and support the retirement plan's goals.

Conclusion

These are tricky times for multiemployer retirement plan boards of trustees. On one hand, they are trying to serve the needs of members who sometimes find themselves being forced to choose between heating and eating. Yet as trustees, they still need to remain focused on the fact that their primary responsibility is as the stewards of these same members' retirement plans. This is not an easy place to be—keeping an eye on the future while being challenged by people who have needs that must be met today. **B&C**

Endnote

1. *The Segal Study of Multiemployer Defined Contribution Plans* reflects information for just under 140 funds, all but two of which are Segal clients. The study sample represents 9% of all multiemployer DC plans. As a group, the DC plans in the study cover more than 600,000 lives and have more than $15 billion in assets.

For information on ordering reprints of this article, call (888) 334-3327, option 4.

Reproduced with permission from *Benefits & Compensation Digest,* Volume 47, No. 1, January 2010, pages 26-29, published by the International Foundation of Employee Benefit Plans (www.ifebp.org), Brookfield, Wis. All rights reserved. Statements or opinions expressed in this article are those of the author and do not necessarily represent the views or positions of the International Foundation, its officers, directors or staff. No further transmission or electronic distribution of this material is permitted.

David B. Brenner, J.D. is a senior vice president and benefits consultant in the Boston office of The Segal Company. He specializes in consulting to multiemployer funds, including DB and DC pension plans. He holds a bachelor of arts degree with a concentration in labor studies from the University of Massachusetts at Amherst and earned his J.D. degree from Northeastern University School of Law.