Segal Consulting

update

Compliance News for Multiemployer Plans

September 15, 2016

Multiemployer "Composite Plan" Draft Legislative Language Released

On September 9, 2016, draft legislative language ("Discussion Draft") was released by House Education and Workforce Committee Chairman John Kline that, if enacted into law, would give the multiemployer community a new kind of retirement plan that is designed to provide benefits in the form of lifetime income to participants, but does not saddle contributing employers and unions with the financial uncertainties of traditional multiemployer defined benefit (DB) plans.[1]

The new kind of multiemployer plan, the "Composite Plan,"[2] is neither a DB plan nor a defined contribution (DC) plan. Instead, it combines attributes of both DB and DC plans by providing the benefit structure of a DB plan but limiting the employers' obligation to negotiated contributions similar to a DC plan.

It is too soon to know if and when actual legislation will be introduced in Congress, and how any final legislation will differ from what was released September 9th. This *Update* describes the features of the Composite Plan as provided in the Discussion Draft.

Retirement Compliance News Highlights:

- Legislative Discussion Draft for new multiemployer Composite Plan design released September 9, 2016.
- Composite Plans require that benefits earned and paid be aligned with the financial standing of the plan.
- Composite Plans are not covered by the PBGC.

Background

There has been growing concern in the multiemployer plan community about the ability to attract new employers to, and retain existing employers in, multiemployer DB plans due to plan underfunding, with specific concerns regarding "legacy costs" and withdrawal liability. The Composite Plan design is intended to help address that concern with a plan-design option that plan sponsors could adopt voluntarily. The plan-design option provides an annuity benefit, but limits an employer's financial obligation to its fixed, negotiated contribution level. It also eliminates both the withdrawal liability "exit fee," should the employer decide to leave the plan, and the penalties if plan funding drops too far.

The Composite Plan requires that benefits earned and paid be aligned with the financial standing of the plan. To reduce the likelihood of a Composite Plan becoming underfunded, the funding requirements are more rigorous and operate quite differently than those currently applicable to multiemployer DB pension

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[1] This is the link to the Discussion Draft: http://edworkforce.house.gov/uploadedfiles/composite_a_xml.pdf.

[2] The new design is based on a design proposed in the National Coordinating Committee for Multiemployer Plans' 2013 Retirement Security Review Commission report entitled *Solutions Not Bailouts*. Many of that report's recommendations were included in the Multiemployer Pension Reform Act (MPRA), passed in December 2014. The proposed design was not included as part of MPRA, but has now been translated into legislative language for public comment.

plans: Composite Plans must maintain a projected funded ratio of 120 percent. However, to ensure that assets are sufficient to pay benefits, the Composite Plan is required to reduce benefits to the level that can be supported by the assets. The benefit reductions are not automatic, but are instead determined through a process of trustee deliberation, one of the essential features of the multiemployer pension system. This analysis takes place every year, so participants' benefits and the plan's assets are kept in balance throughout, not just at a point when the plan is in crisis. The conservative, forward-looking funding approach built into the Composite Plan, coupled with the multiemployer governance structure, is designed to share pension risks between plan sponsors and participants in a balanced manner.

Key Features

The key features of Composite Plans are as follows:

- Composite Plans are multiemployer plans that can be established as stand-alone plans or as components of existing multiemployer DB plans.
- They are covered plans under the Employee Retirement Income Security Act (ERISA) and subject to the rules of fiduciary conduct.
- A significant exception is that the ERISA provisions related to the Pension Benefit Guaranty Corporation (PBGC) do not apply. Composite Plans do not pay PBGC premiums and the benefits of participants in these plans are not guaranteed by PBGC. Employers contributing to Composite Plans are not subject to withdrawal liability.
- Composite Plans are intended to be tax-qualified plans under the Internal Revenue Code (IRC). Except to the extent they are replaced or modified by the Composite Plan rules, the tax qualification rules for multiemployer DB plans will apply, but Composite Plans are not subject to the minimum funding rules.
- Composite Plans include benefit provisions that mimic DB plan provisions: they must pay benefits in the form of annuities, including qualified joint and survivor annuities, and may offer other optional forms. They may not pay lump-sum distributions in amounts above $5,000.
- Composite Plans must be certified by the actuary to have a projected funded ratio of 120 percent after 15 years. The funded status of the plan is re-determined annually, and if the plan does not have a projected funded ratio of at least 120 percent, it must adopt a remedial “realignment program” that lays out the steps to be taken by the plan, and recommended to the bargaining parties, to increase the projected funded ratio.
- Available remedial measures under a Composite Plan’s realignment program depend on the severity of the plan’s projected funding shortfall and can include, as a last resort, reductions to core benefits of participants in pay status.
- To ensure that the interests of retirees are represented, when at least 5 percent of the plan’s participant population is in pay status, a Composite Plan must have at least one retiree on its Board of Trustees.
- Composite Plan benefit improvements are strictly regulated and can be made only when the plan’s current funded status is strong and is projected to remain strong even after the benefit improvements.
- A multiemployer DB plan is a legacy plan with respect to a Composite Plan to the extent that a class of employees that were eligible to accrue benefits under the DB plan becomes eligible to accrue benefits under the Composite Plan. Except as specified in the Discussion Draft, legacy DB plans remain subject to current law.

- Collective bargaining agreements (CBAs) providing for participation in a Composite Plan must require all employers to contribute at least the “Transition Contribution Rate” (TCR) to an associated legacy plan, presumably even for employers who previously did not contribute to the legacy plan and for newly hired employees of legacy plan employers who will not be accruing benefits under the legacy plan.
- For legacy plans that achieve “full funding,” the TCR requirement and withdrawal liability are completely and permanently eliminated.

Composite Plan Mechanics

A Composite Plan is a tax-qualified multiemployer plan that is also covered by ERISA, except that that the PBGC-related provisions of ERISA do not apply to Composite Plans. It may be established as a new stand-alone plan or adopted as a separate “component” of an existing multiemployer DB plan, as long as that plan is not currently certified in critical status or projected to be in critical status within the next five years. If a multiemployer DB plan adopts a Composite Plan component, the assets of the entire plan must be held in a single trust but assigned to separate sub-trusts with separate recordkeeping. The assets may be pooled for investment purposes. In no event can assets in the DB component be used to pay benefits under the Composite Plan component, or vice versa.

“A Composite Plan is a . . . multiemployer plan . . . that may be established as a new stand-alone plan or adopted as a separate ‘component’ of an existing multiemployer DB plan.”

Benefits

A Composite Plan is very similar to the current DB plan model that is familiar to members of the multiemployer community. Under a Composite Plan, benefits are paid at retirement in the form of an annuity; the only lump sums permitted are small lump sums of $5,000 or less. Plans will include features that are currently required for DB plans, such as vesting provisions, with recognition of vesting service for participants with service in both the legacy and Composite Plan components, and qualified joint and survivor annuities. Plans also may include optional features such as early-retirement subsidies, death and disability benefits and optional annuity payment forms, including for example, 60-month guarantees.

Funding

Contributions under a Composite Plan are fixed through the bargaining process. Future benefit accruals are in the amount that can be supported by the negotiated contribution rate. Initially, contributions and benefits must be aligned so that the contribution rates are projected to cover at least 120 percent of the cost of the benefits to be earned. On an ongoing basis, a Composite Plan must have assets and contribution levels that result in a projected funded ratio of 120 percent within 15 years.

As described in more detail below, if projected assets are less than 120 percent of projected liabilities, the trustees must take remedial action that can include recommended negotiated contribution increases, reductions in benefits or both.

Annual Certification

No later than the 120th day of each plan year (*e.g.,* by the end of April for a calendar-year plan), the actuary must certify the Composite Plan’s *current* and *projected funded ratio*. The *current funded ratio* is the fair market value of assets as of the first day of the plan year divided by the actuary’s best estimate of the plan’s liabilities for benefits accrued as of that same date. The *projected funded ratio* is a similar funded ratio calculation, with assets and liabilities projected 15 years (to “the first day of the 15th year following the current year.”)

As under current law, trustees provide the actuary with input on expected industry activity levels — anticipated employment and contribution base units — over the projection period. For this certification, the actuary may include “presumed” contribution rate increases beyond the term of the current collective bargaining agreement(s) up to a maximum increase of 2.5 percent per year, unless those increases would be deemed unreasonable under the circumstances.

Realignment Program

If the actuary certifies that the projected funded ratio is less than 120 percent, the trustees must adopt a written *realignment program* within 210 days after the due date of the certification (*e.g.,* by the end of November for a calendar-year plan). The realignment program must be reevaluated and updated for each subsequent plan year that the projected funded ratio is less than 120 percent.

The realignment program must consider "all reasonable measures" to enable the plan to reach a projected funded ratio of 120 percent for the next plan year. Reasonable measures are actions trustees can take or recommend to the bargaining parties that are expected to enable the plan to achieve the necessary funded ratio in the necessary time period. They consist of proposed contribution increases and three tiers of benefit reductions, ranging from reductions in future accruals (subject to a floor) to equitably distributed reductions of *core benefits* for both non-retirees and retirees. A *core benefit* is a participant's accrued benefit payable in the normal form for the plan beginning at normal retirement age, without regard to any early retirement-type subsidies or other benefits, rights or features, and without regard to any cost-of-living or other benefit increases that were effective after the date the participant retired. Benefit reductions may be designed to be contingent upon failure of the bargaining parties to achieve the required contribution rate increases.

There are three tiers of reasonable measures that the trustees may consider, with the harshest "third-tier" measures available only when first- and second-tier measures cannot solve the problem.

First-tier measures are:

- Increases in contribution rates to be proposed to the bargaining parties,
- Reductions in the future benefit accrual rate, subject to a 1 percent of contributions floor (or an equivalent rate), and
- Reduction or elimination of "adjustable benefits" for participants not yet in pay status. These are the same types of benefits that may be reduced under existing law within a Rehabilitation Plan for a multiemployer DB plan in critical status.[3]

If the first-tier adjustments are not sufficient to produce a projected funded ratio of 120 percent, the realignment program can include reasonable measures from the second-tier:

- Reductions in already accrued benefits for participants *not yet in* pay status, and
- Reductions in any benefits for participants *currently* in pay status, *except* core benefits.

If reasonable measures from the first- and second-tier of adjustments and reductions are not sufficient to produce a projected funded ratio of 120 percent, the realignment program can include reasonable measures from the third-tier, but only to the extent required to enable the plan to achieve either (i) a projected funded ratio of 120 percent,

[3] See Segal's August 2006 *Bulletin*, "Pension Protection Act of 2006's Key Multiemployer Plan Provisions on PPA'06."

or, at the plan sponsor's election, (ii) a projected funded ratio of 100 percent and a *current funded ratio* of at least 90 percent:

- Further reduction in the rate of future benefit accruals, without regard to the 1 percent of contributions floor, and
- A reduction in core benefits.

Such reductions must be distributed equitably across all participants and beneficiaries, taking into account factors that may include one or more of the factors that apply to the equitable distribution of benefit suspensions for Critical and Declining plans under MPRA.[4]

Limitations on Benefit Improvements

Under a Composite Plan, there are strict rules in place regarding the adoption of benefit increases. Trustees may improve benefits only when all of the following funding measures are met:

- The current funded ratio is at least 110% without regard to the increase, and the increase would not cause it to fall below 100%,
- The projected funded ratio, after reflecting the increase, is at least 120% after 15 years, and
- The increase in accrued benefits is limited to no more than 3%. However, if both the current and projected funded ratios are at least 140% after the improvement, there is no limit on the size of the benefit increase as long as other applicable requirements are satisfied; and
- Expected contributions for the current year are at least 120% of the cost of benefits accruing during the current year, after reflecting the increase.

Previously reduced core benefits may be restored but *not* retroactively, and such restorations must be equitably distributed across the classes of affected participants.

"Under a Composite Plan, there are strict rules in place regarding the adoption of benefit increases."

Legacy Plan Mechanics

A multiemployer DB plan is a *legacy plan* with respect to a Composite Plan to the extent that a class (or classes) of employees that were eligible to accrue benefits under the DB plan become eligible to accrue benefits under the Composite Plan.

Continuing contributions (transition contributions) are required to be made to the legacy plan, as discussed below. Also, there is a five-year ban on Composite Plan participation for employers that have ceased to have an obligation to contribute to a multiemployer DB plan.

Legacy plans that freeze future accruals for participants who go into Composite Plans have the option of taking funding relief in the form of a 30-year amortization of the existing unfunded liabilities. For those legacy plans that become fully funded, as defined below, transition contribution requirements and withdrawal liability are eliminated.

Transition Contribution Rate and Continuation of Contributions

A Composite Plan cannot accept a CBA unless it requires the employer to make a contribution to the legacy plan associated with the Composite Plan. The legacy plan contribution must be at least the amount of the *transition contribution rate* (TCR) determined by the legacy plan. This appears to apply regardless of whether the particular employer ever had employees participating in the legacy plan.

[4] See Segal's December 2014 *Bulletin*, "Multiemployer Pension Reform Passed by Congress Expected to Become Law."

The initial TCR is the rate certified by the legacy plan's actuary to fund the cost of the benefits being earned during the year (if any) and to pay off the legacy plan's unfunded liabilities over 25 years. The legacy plan's actuary re-determines the TCR every year, and any subsequent changes in the legacy plan's unfunded liability (due to experience gains or losses, changes in actuarial assumptions, changes to the legacy plan's benefits or changes in funding method) are amortized over 15 years. The annually re-determined TCR can never be less than the initial TCR.

If the legacy plan goes into endangered or critical status, the TCR can go up as required by the legacy plan's remedial program; however, this cannot result in more than 75% of the total retirement plan contributions being earmarked for the legacy plan.

The current ERISA funding rules for multiemployer DB pension plans, including all requirements of the PPA and MPRA, continue to apply to legacy plans. The required contributions to the legacy plan will be the greater of the level normally required by the DB plan (including any rehabilitation/funding improvement plan schedules) and the TCR.

Employers must contribute at least the TCR until the legacy plan's actuary is able to certify that the plan is "fully funded" as defined below.

Withdrawal Liability for New Employers

Employers that never had an obligation to contribute to the legacy plan, and only contribute to the Composite Plan, will not be subject to withdrawal liability under an associated legacy plan as a result of TCR contributions that are required to be contributed to the legacy plan.

Restrictions on Employee Benefits in Composite Plans

If an employer under a CBA that was entered into after the enactment of this legislation ceases to have an obligation to contribute to the legacy plan, employees of that employer may not accrue a benefit under the Composite Plan for five years. Similarly, if the employer's negotiated contribution rate to the legacy plan is below the TCR, participants' Composite Plan accruals stop.

Full Funding of the Legacy Plan

Once the legacy plan's actuary certifies that it is "fully funded," has been fully funded for at least three of the last five years and is projected to remain fully funded for the following four years, the transition contributions and restrictions on employer participation in a Composite Plan after withdrawal from the legacy plan are no longer required. Moreover, in the event of full funding, the withdrawal liability rules applicable to the legacy plan no longer apply.

For these purposes, "fully funded" is determined based on the legacy plan's actuarial liability for benefits earned to date and its market value of assets, using the assumptions promulgated by PBGC for plans terminating by mass withdrawal that reflect the pricing of the current group annuity market.

Reporting and Disclosure

There are, of course, a number of new notices required for both Composite Plans and legacy plans under the draft legislative language. These include:

- Notice that the Composite Plan is required to adopt a realignment program because its projected funded ratio is less than 120 percent, including an estimate of the contribution increases and benefit reductions that may be required,
- Advance notice that the Composite Plan's realignment program includes benefit reductions,
- Notice that a Composite Plan CBA is rejected (and no contributions can be accepted or benefits accrued) because it fails to provide contributions to the legacy plan that satisfy the transition contribution requirements,

- Notice from the legacy plan to the Composite Plan of employer withdrawals, and subsequent advance notice from the Composite Plan about related cessations of accruals,
- Advance notice that a legacy plan TCR for a CBA will be changing, and
- Notice from the legacy plan to the Composite Plan under which employees covered by the CBA would otherwise be able to accrue benefits, that a CBA provides for a contribution rate that is below the TCR rate for one or more employers.

Generally, each notice must be provided to the affected parties (which can include, depending upon the notice, participants and beneficiaries, bargaining parties, and government agencies) within a 30-day period of the relevant date, and must describe the meaning and consequences of the event that made the notice necessary.

In addition, Composite Plans will be required to provide Annual Funding Notices and file annual reports (Forms 5500) as prescribed by the Department of Labor and the Treasury Department.

PBGC-Related Issues

Because a Composite Plan is not a DB plan, benefits are not guaranteed by the PBGC, and no premiums are due on participants covered solely by a Composite Plan.

By definition, the Composite Plan has no withdrawal liability. Employer obligations with regard to the plan are limited to the negotiated contribution levels. This provision is intended to provide more financial certainty to the employers' obligations. The lack of withdrawal liability could also remove a significant obstacle to new employers joining a plan.

Benefits under the legacy plan continue to be guaranteed by the PBGC, with premiums due on all participants with a benefit under the legacy plan.

Although transition contributions to the legacy plan are required, both they and withdrawal liability for the legacy plan will be permanently eliminated once that plan has achieved "full funding" as defined above.

How Segal Can Help

If enacted into law, the Composite Plan would offer plan sponsors and trustees a new tool to help them address the real and significant issues facing them. While it may not be an appropriate solution for all plans, the Composite Plan could be a viable and valuable option in some situations.

One of the topics of discussion by trustees of many plans, regardless of funding or industry, is whether and how risk-sharing between employers and employees can be structured to provide both lifetime retirement income to plan participants and more stable (if not fixed) costs to contributing employers. The introduction of this new design may be a good starting point for trustees to begin to compare and contrast the many alternatives available to them to lower or manage the various risks multiemployer defined benefit plans face.

Your Segal consultant can help you understand the features of this new plan design and other plan designs, and advise you on their associated advantages, disadvantages and costs.

Questions?

For more information about the Composite Plan legislation, please contact your Segal consultant or the Segal office nearest you.

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