Pension Protection Act of 2006 Multiemployer Plan Provisions

A MILLIMAN GLOBAL FIRM

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Consultants and Actuaries

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CAVEAT

Information contained in and presented through this material is intended to provide a general understanding of the topics included, based on our understanding of applicable laws. Application to specific situations may involve additional laws and issues beyond the scope of the material presented here. This presentation is not intended nor should be construed nor used as legal advice, investment advice, tax advice, or any other professional service.

INTRODUCTION

- Massive overhaul of ERISA
- Entirely new single-employer funding
  - Based on unfunded accrued benefits
  - Prescribed assumptions
  - Unit credit only
  - Amortize shortfall over seven years
- Broad new disclosure for DB & DC

Multiemployer Changes

- Minor changes in withdrawal liability
- Important new disclosure rules
- Same basic funding rules with adjustments
- 75% J&S option required, effective 2008/2009
- New rules for financially troubled plans
- Many outstanding questions

Withdrawal Liability
Construction & contracting out

- Construction industry plans
  - Free-look option
  - Fresh-start option
  - Effective Jan. 1, 2007
- Cessation of obligation to contribute
  - Applies to transferring covered work to another entity owned or controlled by employer
  - Effective Aug. 17, 2006
  - What is the difference from current law?

Withdrawal Liability
Avoid or evade assessments

- No interim payments for avoiding or evading assessments made:
  - Five years after event for small employers
    - not more than 500 employees total; 250 covered
  - Two years for others
  - Employer must notify plan of election w/in 90 days
  - Bond or escrow if not resolved in 12 months
  - Effective for transactions after 1998

Withdrawal Liability
Sale of assets

- Lower liability for sale of assets
  - 30% of net proceeds up to $5 million, stepping up to 80% in excess of $25 million
  - Direct attribution only for plans using that method
  - Effective Jan. 1, 2007
- Unlawful to discriminate against employer for exercising ERISA rights or testifying on ERISA before Congress

Estimate of Withdrawal Liability

- Effective beginning 2008 plan year
- New notice requirement added to Title I
  - Supply estimate upon employer written request within 180 days
  - Possible penalty of $1,000 per day
  - Does not eliminate similar requirement in Title IV
- Information required
  - Estimated liability for withdrawal on last day of prior PY
  - Explanation of how calculated, allocation method actuarial assumptions, and annual changes in UVB
  - Employer contributions
- Charge for copying, mailing, “other costs”?

Disclosure
Funding Notice

- Effective 2008 plan year
- Due 120 days after beginning of plan year
- Additional information for all plans
  - Number of participants receiving benefits, deferred vested, and active
  - Funding policy and asset allocation
  - Specific information on any plan amendment or scheduled change in benefits
  - Notice of event having material effect (as defined in DOL regulations)
  - Notice of ability to get annual report from DOL Web site or plan sponsor intranet Web site

Funding Notice Multiemployer

- Funded percentage for prior two plan years
- Assets and liabilities for prior two plan years
- Notice whether plan endangered or critical
  - Description of plan and ability to request info
- Plan administrator will provide copy of annual report upon written request to labor organization, participants or beneficiaries, or contributing employers

Additional Disclosure Form 5500

- Effective for 2008 plan year reports
- Number of contributing employers
- List of 5%+ contributing employers
- Number of participants without contributions for current and two preceding plan years
- Participants with no contributions for current year ÷ participants without contributions for two preceding years
  - DOL to publish guidance to identify and count such participants

Additional Disclosure Form 5500 (cont.)

- Number of withdrawals and amount assessed
- Whether endangered or critical
  - Summary of plan adopted during year
  - Funded percentage
- If merger, show assets and liabilities of merging plans
- Whether plan had extension or used shortfall and difference in required contributions
- Actuarial assumptions and methods used to project future retirements and payment forms

Report to Employers & Unions

- Effective for 2008 plan year report
- Due 30 days after Form 5500 (Aug. 31, 2009)
- Contains basically same additional information as required for Form 5500, plus
  - Contribution schedules, benefit formulas + change
  - If plan critical or endangered, actions taken, how to obtain detailed information on improvement plan
- Sought or received amortization extension or used shortfall funding method

Other Disclosure Changes

- Right to copy of actuarial or investment report
  - ❑ Participants, beneficiaries, employers, unions
  - ❑ 30 days to provide
- Employer to receive notice of reduction in accruals
- Individual benefit statements
  - ❑ Once every three years to vested and upon request
    - ❑ Alternative notice of right and how to obtain
  - ❑ Accrued and vested benefit
  - ❑ Effective 2008 plan year (2009 if existing CBA)

General Funding Changes for Multiemployer Plans

- Effective 2008 plan year
- Funding standard account maintained
- 15-year vs. 30-year amortization for changes from:
  - Amendments adopted on or after 2008 plan year, regardless of effective date
    - Period of payment if shorter (e.g. 13th checks)
  - Changes in actuarial assumptions on or after 2008
  - Implications for timing of amendments and changes in assumptions

General Funding Changes (cont.)

- Reasonable individual actuarial assumptions
  - Experience studies
- Annual valuations including gains and losses
- PFEA loss rules maintained
- Deduction = 140% unfunded current liability, effective beginning in 2006
- Permanent repeal of the 100%-of-compensation limit

Automatic 5-Year Extension

- Effective 2008, IRS must grant amortization period extension for as long as five years if:
  - Plan provides notice to participants and beneficiaries, unions, and the PBGC, including funded status
  - Actuary certifies—
    - Plan would have funding deficiency within 10 years
    - Trustees have taken steps to improve funding
    - Plan will be able to pay benefits through extension period
    - Required notice was given
  - Amortization interest rate is plan funding rate, except federal short-term rate applies for applications before June 30, 2005
- IRS can increase extension for as many as 10 years

Automatic Approval of Shortfall

- Plan may adopt shortfall method if:
  - it hasn't been used for five years; and,
  - it is not operating under an amortization extension

- Benefits of shortfall method—
  - protects against unexpected declines in workforce
  - delays amortization of losses until end of CBA

Actuarial Certification

- Actuarial certification before 90 days after the beginning of the plan year
  - Endangered (Seriously Endangered); or
  - Critical
  - Progress report for each year after endangered or critical
- Projections required for current year and succeeding plan years of assets and liabilities
  - based on reasonable actuarial estimates, assumptions and methods
  - projected industry activity based on good-faith information provided by plan sponsor

Actuarial Certification (continued)

- Failure to certify is treated as a failure to file annual report (as much as $1,100 per day penalty)
- Notification required within 30 days to:
  - participants and beneficiaries
  - bargaining parties
  - PBGC
  - Secretary of Labor

Tests for Endangered Status

- (1) Funded percentage* is less than 80%, or
- (2) Accumulated funding deficiency in the current year or the six succeeding plan years
- A plan that meets both conditions (1) & (2) above is called "Seriously Endangered"
- * Funded percentage = ratio of
    - plan assets to accrued liability
    - accrued liability based on Unit Credit Method

Tests for Critical Status

- Funded percentage (FP) less than 65% and the sum of the market value of assets plus the present value of employer and employee contributions for seven years is less than the present value of all benefits and expenses expected to be paid in each of the seven succeeding plan years
- Accumulated funding deficiency (AFD) in the current plan year (without amortization extensions), or projected to have AFD for three succeeding plan years (four, if FP less than 65%)

Tests for Critical Status (cont.)
Three-part test

- Normal cost (current year), plus interest (valuation rate) on unfunded benefit liabilities, exceeds present value of employer and employee contributions for current year
- Present value on nonforfeitable inactive benefits is greater than the present value of nonforfeitable active benefits
- AFD for current year or projected to have an AFD for any four succeeding plan years (without amortization extensions)

Tests for Critical Status (cont.)
Solvency test

- Sum of the market value of assets, plus the present value of employer contributions for current year and four succeeding plan years is less than the present value of all benefits projected to be payable under the current year and each of the four succeeding plan years (plus administrative expenses)

Testing Example

XYZ Retirement Trust
Taft-Hartley Projection of Endangered & Critical Status
Deterministic Projection

Endangered Test: (1) Under 80% funded <u>OR</u>
(2) Credit balance projected below zero within seven years

Critical Test A: (1) Fails seven-year solvency <u>AND</u>
(2) Under 65% funded

Critical Test B: (1) Credit balance projected below zero within four years, <u>OR</u>
(2) Within five years if funded percent is below 65%

Critical Test C: (1) Credit balance projected below zero within five years,
<u>AND</u> (2) Value vested inactive benefits exceeds value of vested active benefits
<u>AND</u> (3) Normal cost (including expense load) plus interest on unfunded exceeds contributions

Critical Test D: Fails five-year solvency test

Testing Example
Baseline

	1 = True (fails test), 0 = False (does not fail test)						
	Endangered Tests						
	Regular	"Seriously"	Critical Tests				
	(one true)	(both true)	Test A	Test B	Test C	Test D	STATUS
2006	0	0	0	0	0	0	Not Endangered
2007	0	0	0	0	0	0	Not Endangered
2008	0	0	0	0	0	0	Not Endangered
2009	0	0	0	0	0	0	Not Endangered
2010	1	0	0	0	0	0	Endangered
2011	1	0	0	0	0	0	Endangered
2012	1	0	0	0	1	0	Critical
2013	1	0	0	1	1	0	Critical
2014	1	0	0	1	1	0	Critical
2015	1	0	0	1	1	0	Critical
2016	1	0	0	1	1	0	Critical

Effect of Amortization Extension

1 = True (fails test), 0 = False (does not fail test)

	Endangered Tests		Critical Tests				
	Regular (one true)	"Seriously" (both true)	Test A	Test B	Test C	Test D	STATUS
2006	0	0	0	0	0	0	Not Endangered
2007	0	0	0	0	0	0	Not Endangered
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2009	0	0	0	0	0	0	Not Endangered
2010	0	0	0	0	0	0	Not Endangered
2011	0	0	0	0	0	0	Not Endangered
2012	0	0	0	0	1	0	Critical
2013	1	0	0	1	1	0	Critical
2014	1	0	0	1	1	0	Critical
2015	1	0	0	1	1	0	Critical
2016	1	0	0	1	1	0	Critical

Trustee Responsibilities for Endangered and Critical Plans

- Trustees must adopt plan by 330th day of PY: Funding improvement plan for endangered: Rehabilitation plan for critical
- Plans designed to meet funding targets
  - Generally 10 years to meet benchmark
  - Endangered: improve FP by 33% of underfunding
  - Seriously endangered < 70%: Improve FP by 20% over 15 years
  - Critical: improve so no funding deficit projected for CY+9
- Period begins on earlier of 2nd PY beginning after trustees adopt plan or expiration of CBAs covering 75% of actives as of certification due date

Trustee Responsibilities (cont.)

- Must provide default plan that:
  - Cuts future accruals to maximum extent permitted
    - Lowest permitted accrual is 1% of contributions or actuarial equivalent
  - Raises contribution rates <u>only</u> to extent necessary to meet target by end of period
- Communicate plan to bargaining parties within 30 days, showing revised schedules of benefits and contributions
- Failure to adopt plan is subject to $1,100/day penalty

Endangered Vs. Critical

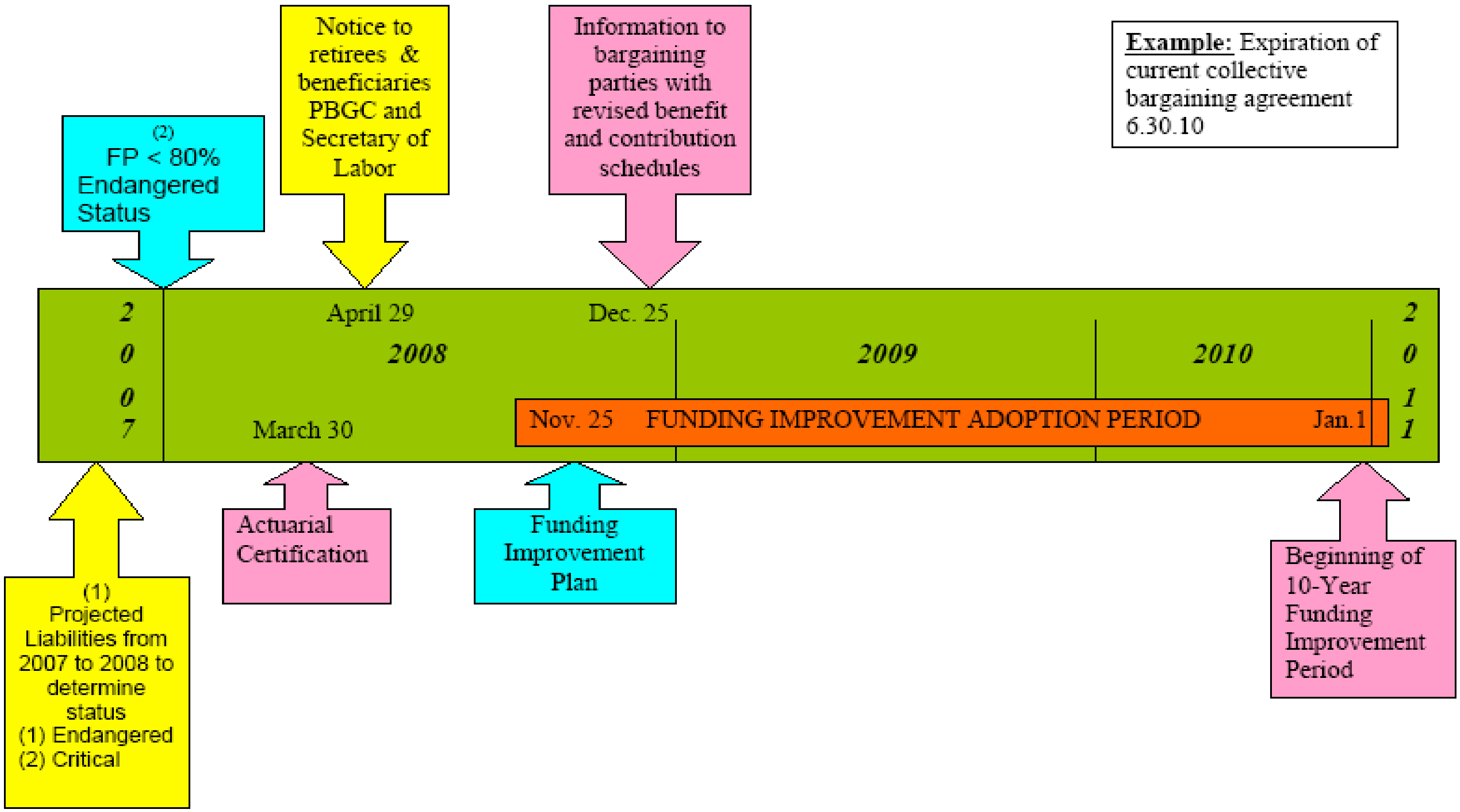
- Endangered subject to excise tax throughout period
- Critical plan must include annual benchmarks
  - Excise tax only if fails three consecutive benchmarks
  - Trustees can determine not reasonable to get out in 10 years or ever
    - Benchmarks if unable to get out?
- Critical can eliminate early retirement subsidies and supplemental benefits for non-retirees and benefit increases in effect < 60 months for all
  - Provide notice 30 days before effective date to participants, beneficiaries, bargaining parties
  - Communicate understandable explanation of effect

Surcharge for Critical Plans

- If plan is critical—
  - Surcharge until parties adopt rehabilitation plan
    - 5% for first year in critical status
    - 10% for each succeeding year
    - Applies 30 days after employer is notified
    - Due and payable on same schedule as contributions
    - Failure to pay is treated as a delinquent contribution
    - Disregarded for withdrawal liability calculations

TIMELINE

Funding Improvement Plan



Trustee Actions During Adoption Period

- Trustees may not accept a CBA that reduces contribution rate or excludes employees
- Trustees can't increase benefits
- If the plan is "Seriously Endangered"
  - Plan sponsor must take all reasonable actions, consistent with the terms of the plan and present law to increase the funded percentage and postpone deficiency for at least one plan year, including application for extension or use of shortfall method
- If the plan is "Critical," trustees must only pay benefits as annuities, except for lump sums of $5,000 or less

Effect of Failure to Adopt Plan

- If bargaining parties fail to adopt a schedule of changes to contributions or benefits provided by trustees, default schedule is implemented
  - Default schedule implemented on the earlier of
    - Date Secretary certifies that the parties are at an impasse
    - 180 days after CBA expires
- Excise tax equal to contributions under default schedule if not paid

Excise Tax on Employers

- Endangered Plans
  - Tax equal to unpaid contributions required under the FIP
- Seriously Endangered Plans
  - Excise tax if benchmark not met by end of improvement period equal to the greater of amount needed to meet benchmarks or amount needed to avoid a funding deficiency
  - Tax applies each year until benchmarks are met
- Critical Plans
  - No excise tax if rehabilitation plan adopted unless plan fails to meet benchmarks for three consecutive years
  - Tax is greater of amount needed to meet benchmark or accumulated funding deficiency
- Waiver of excise tax
  - Secretary of Treasury may waive all or part of the excise tax depending on circumstances

Future Cost Examples

- Hypothetical example of a financially troubled plan
  - Funding projections
    - Baseline
    - Reduction in future accruals
    - Reduction in future accruals and modest contribution increase
    - Contribution increase required to avoid endangered status

Additional Guidance

- Projected liabilities from 2007 and actual 2008 assets to determined funded percentage?
- Plan amendments adopted after beginning of PY and before certification

QUESTIONS