Special Report

What Employers Might Expect from Multiemployer Pension Plans Following COVID-19 Crisis

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The COVID-19 crisis portends a new and troubling outlook for employers participating in multiemployer pension plans. While many multiemployer pension plans had been recovering enough from the 2007 – 2009 Great Recession to have their funding levels approach or exceed their 2007 funding levels, the COVID-19 crisis now threatens those recoveries and the solvency of the most financially troubled plans.

Proactive employers participating in multiemployer plans should anticipate how the plan's potential financial downturn will affect their finances and the retirement benefits of their unionized employees, and plan accordingly.

The following provides a brief review of the Great Recession's effect on multiemployer plans, and then an overview of COVID-19's potential effect.

The Great Recession

The years following the Great Recession brought:

1. A spike in the number of multiemployer plans projected to become insolvent;

2. Contribution rate hikes imposed on contributing employers in significantly underfunded multiemployer plans pursuant to the Pension Protection Act of 2006;

3. The growth of the "unfunded vested benefits" of many multiemployer plans directly resulting in the corresponding growth of the withdrawal liability of employers that ceased their participation in such plans (unfunded vested benefits is one measurement of underfunding and may be thought of as the difference between the present value of the pension fund's assets and the present value of its future benefit obligations to retirees and beneficiaries);

4. Passage of the Multiemployer Pension Reform Act of 2014, establishing a process for multiemployer plans nearing insolvency to reduce the pension benefits payable to current retirees;

5. The rate of the premium payable to the Pension Benefit Guaranty Corp. (PBGC), the federal agency tasked with insuring the benefits payable from multiemployer plans, jumping from $8 per participant in 2007 to $30 per participant in 2020; and

6. Such an increase in the number of multiemployers plans requiring the PBGC's financial assistance that the PBGC, in its 2019 annual report, projected its multiemployer insurance program to be insolvent by 2025 (and possibly sooner), leaving affected retirees not only with benefits significantly less than promised by the troubled plan, but also significantly less than the level of benefits guaranteed

by the PBGC.

The COVID-19 Crisis

The trends that emerge with multiemployer pension plans during and after the COVID-19 crisis may be worse than that following the Great Recession.

1. **An Increase in Potential Withdrawal Liability**

Under the Employee Retirement Income Security Act (ERISA), the federal law governing retirement plans, an employer withdrawing from an underfunded multiemployer plan is liable for the employer's share of the plan's unfunded vested benefits (UVB). Generally, the greater the plan's UVB, the larger the employer's withdrawal liability (but only up to the point where a statutory 20-year cap on withdrawal liability payments limits the employer's liability regardless of an increase in a plan's UVB).

The UVB amount depends on the plan's funding and benefit obligations. Multiemployer plans are funded primarily by employers (through contributions and withdrawal liability payments) and returns on investments. The partial shutdown of the economy and stock market losses in 2020 will affect both sources as some employers will be unable to make the required payments and plans will realize significant investment losses. Eventually, less funding will lead to greater UVB and, most likely, greater withdrawal liability for employers. The anticipated bankruptcy filings of withdrawn employers and the resulting discharge of withdrawal liability obligations also could drastically increase the amount of UVB allocated to employers.

The surge in the amount of withdrawal liability will not be felt immediately by withdrawing employers. In calculating an employer's withdrawal liability, the date of valuation for a plan's UVB is the last day of the plan year *preceding* the date of the employer's withdrawal. Thus, for example, an employer that withdraws in 2020 from a multiemployer plan with a plan year that ends on December 31 may be fortunate to have its withdrawal liability determined based on the funding of the plan as of December 31, 2019 (*i.e.,* before the plan's financial records reflect the downturn of the economy). Employers with collective bargaining agreements (CBAs) that expire during the 2020 plan year may want to consider negotiating out of the plan to avoid having their withdrawal liability include the anticipated investment losses during the 2020 plan year.

For more on how COVID-19 may affect an employer's withdrawal liability, including the possibility of a partial withdrawal due to closings or a reduction in force, see our article, COVID-19 and Withdrawal Liability.

2. **Demand for Additional Withdrawal Liability Payments from Employers Already Withdrawn**

Mass Withdrawals

In certain instances, an employer that has withdrawn and fully satisfied its withdrawal liability obligations may be required to make additional withdrawal liability payments to a multiemployer plan that experiences a "mass withdrawal."

A mass withdrawal occurs where either (i) *every employer* has withdrawn or ceased having an obligation to contribute under the plan, or (ii) *substantially all employers* have withdrawn pursuant to an agreement or arrangement.

A mass withdrawal is not within the employers' exclusive control — the trustees to a pension fund may initiate a mass withdrawal by ending all obligations for employers to contribute to the plan.

Certain special rules apply when a mass withdrawal occurs. The most important is the lifting of the 20-year cap on the annual payments of withdrawn employers. The PBGC takes the position that when a plan suffers the type of mass withdrawal where *every* employer withdrew or ceased having an obligation to contribute to the plan, the 20-year limitation on withdrawal liability payments is inapplicable for any previously withdrawn employer, *no matter how long ago the employer withdrew*. In other words, following a mass withdrawal, a multiemployer plan may try to recover additional withdrawal liability payments from any employer that withdrew prior to the mass withdrawal if the employer had benefited from the 20-year cap on withdrawal liability payments.

In the case of a mass withdrawal in which substantially all employers withdraw pursuant to an agreement or arrangement, the loss of the 20-year cap applies only to employers withdrawing pursuant to the agreement or arrangement. However, any employer that withdrew during the three consecutive plan years prior to the mass withdrawal is presumed to be a part of the agreement or arrangement and should be subject to the more onerous liability calculations for mass withdrawals.

Loss of Special Withdrawal Liability Exemption

Some employers may have withdrawn without incurring any withdrawal liability because they satisfied one of the exemptions for specified industries. The most common exemption is for the "building and construction" industry. Under this rule, a qualified employer will not incur a "withdrawal" from the applicable plan if the employer ceases to perform any work of the type for which contributions were previously required and does not resume such work on a non-covered basis within the jurisdiction of the CBA during the following five years.

Employers that relied on this exemption to avoid withdrawal liability can expect the pension funds to closely scrutinize that five-year period for any continuation or resumption of covered work, with extra focus on the work of any related companies within the employer's "controlled group" and any subcontractors. If the multiemployer plan finds the employer continued or resumed covered work within the five-year period within the labor agreement's jurisdiction, the plan will issue a demand letter for withdrawal liability.

3. **Increase in Personal Responsibility**

For withdrawal liability purposes, both the entity with the direct obligation to contribute to the plan and all trades or businesses under common control with the contributing entity (the "controlled group") are jointly and severally liable for the withdrawal liability.

Moreover, while a shareholder or an officer of a corporation is generally not personally liable for the corporation's withdrawal liability, an individual may be found personally liable under some circumstances. For example, if the participating business or any of its controlled group members is conducted in the form of a "pass-through" entity that does not provide limited liability (like a general partnership or sole proprietorship), personal liability for withdrawal liability may be imposed on the owners.

As employers face cash-flow issues and are unable to make the required withdrawal liability payments, multiemployer plans are expected to broaden their searches for liable parties and take actions against current and former related entities to the participating employer, including individuals where possible.

4. **Increase of Contribution Rates**

The Pension Protection Act of 2006 created new funding classifications for multiemployer pension plans, with the more seriously underfunded plans being required to take corrective action to improve their funding levels. The three classifications are: (i) "endangered" status (colloquially, "yellow zone"); (ii) "critical" status (the "red zone") for plans with more serious funding problems; and (iii) "green zone" for those that are sufficiently funded so as not to require any mandated corrective action.

Multiemployer plans that are in the yellow zone or red zone are required to establish a funding improvement plan (for those in the yellow zone) or rehabilitation plan (for those in the red zone). The funding plan must include at least one schedule to be presented to the bargaining parties (*i.e.,* the employer and union) that involves a combination of decreased benefits and, almost always, increased contributions. A multiemployer plan will not comply with any CBA that fails to meet the minimum requirements of the funding improvement plan or rehabilitation plan. If the bargaining parties fail to adopt one of the schedules within 180 days after expiration of the CBA in effect at the time the plan entered endangered or critical status, the plan must impose a default schedule.

For plans newly classified as being in the red zone, a participating employer must pay to the plan an automatic surcharge of up to 10% on contributions until the employer is party to a CBA or participation agreement with contribution rates compliant with the rehabilitation plan.

In 2015, 63.7% of the multiemployer plans reported being in the green zone. The COVID-19 crisis likely will cause some of these plans to be reclassified in the yellow or red zone and require employers to increase their contribution rates. For newly classified plans, employers should receive the funding improvement plan or rehabilitation plan within 360 days of the first day of the plan year of the new classification.

5. **Plan Insolvency and Benefit Reductions**

Data from the Form 5500 for the 2015 plan year showed that 83 multiemployer pension plans reported they were in critical and declining status and expected to become insolvent within the next 20 years. An additional 70 multiemployer plans had exhausted reasonable corrective actions and would be unable to emerge from critical status or become insolvent. In 2017, 113 multiemployer plans (9.2% of all multiemployer pension plans covering 11.8% of all participants in multiemployer plans) reported they were in critical and declining status and likely to become insolvent within 14 years or 19 years, as specified by law.

After the COVID-19 crisis, these numbers are likely to increase. A multiemployer pension plan becomes insolvent when it is unable to pay participants the entirety of their promised benefits in a given year. When a plan becomes insolvent, it may request a "loan" from the PBGC (the loans are not expected to be repaid). As a condition for the loan, a plan must *reduce* participants' benefits to the PBGC maximum amount.

The PBGC maximum benefit is the product of a participant's years of service multiplied by the sum of (1) 100% of the first $11 of the monthly benefit accrual rate and (2) 75% of the next $33 of the accrual rate. For 10 years of service, the maximum annual guaranteed benefit is $4,290; for 20 years of service the maximum annual guaranteed benefit is $8,580; and for 30 years of service the maximum annual guaranteed benefit is $12,870.

If the PBGC multiemployer insurance program itself becomes insolvent (discussed below), it will not be able to provide financial assistance for insolvent plans to pay benefits at even the already-reduced PBGC-guaranteed level. The PBGC estimates that most participants would receive less than $2,000 a year because it would be able to provide annual financial assistance equal only to its annual premium revenue (which was $310 million in fiscal year (FY) 2019).

For multiemployer plans that are not yet insolvent but approaching insolvency (classified as being in critical and declining status), the Multiemployer Pension Reform Act of 2014 (MPRA) provides an avenue to reduce current retiree benefits before becoming insolvent. As of April 1, 2020, the U.S. Treasury has approved 17 of 41 applications to reduce benefits under MPRA (of the other applications, five were denied, 15 were withdrawn, and four are under consideration).

6. **Expected Insolvency of PBGC Multiemployer Insurance Program**

At the end of FY 2019, the PBGC reported a deficit of $65.2 billion in its multiemployer insurance program. In its FY 2018 Projections Report, the PBGC indicated its multiemployer insurance program faced a 90% chance of insolvency before the end FY 2025, and a 99% chance by FY 2026. The PBGC's next projections following the COVID-19 crisis probably will show a much earlier expected date of insolvency.

The PBGC is required by ERISA to be self-supporting and receives no appropriations from general revenue. The PBGC multiemployer insurance program has two sources of revenue: (i) premiums paid by the sponsors of the multiemployer plans; and (ii) interest income from holdings of the U.S. Treasury debt. The premium rate is set by Congress and indexed to increases in the average national wage.

There does not seem much the PBGC can do to avoid insolvency of its multiemployer insurance program without financial assistance.

Legislation and Financial Assistance

The impending crisis with the PBGC and multiemployer pension plans has been known for years, but Congress has been slow to act. The Bipartisan Budget Act of 2018 created a joint select committee of the House and Senate tasked with formulating recommendations and legislative language by November 30, 2018, to significantly improve the solvency of the PBGC and multiemployer pension plans. The committee has yet to release any recommendations.

Congress is considering new legislation to address the problem but has not yet included it as part of its COVID-19 response. For a description of the legislation under consideration, see our articles, Will New Stimulus Bill Include Multiemployer Pension Reform? and CARES Act Leaves Out Bailout of Private Union, Multiemployer Pension Plans.

From the perspective of a contributing or withdrawn employer, any new legislation is unlikely to provide much relief. The policies being considered are focused on assisting the PBGC, multiemployer plans, and the retirees in the plans. Employers are one of the potential sources of additional revenue to finance such assistance. Of course, policies too demanding on employers that result in bankruptcies may lead to a reduction of revenue.

Planning Ahead

Given the substantial liabilities inherent in multiemployer plan participation, failing to investigate exposures and undertake proper planning can have severe consequences. To reduce (or evaluate) their risks, employers should consider:

- Determining their current withdrawal liability exposure:
    - Obtain current withdrawal liability estimate annually from the multiemployer plan.
    - Review governing plan documents, focusing on special plan funding rules and any special industry rules (*e.g.,* construction, entertainment, or retail grocery) affecting withdrawal liability.
    - Review plan notices regarding its funding status.
- Assessing whether a complete or partial withdrawal may occur given the employer's current and projected operations;
- Undertaking a review of what related entities to the contributing business may be jointly and severally liable, and the whether the owners may be personally liable;
- Engaging a pension actuary to review the financial condition of the plan; and
- Reviewing collective bargaining strategies for managing the risk of withdrawal liability.

The range of considerations and issues relating to multiemployer plans is significant, and distinct for each employer. Given the complexities involved, employers would be well-served to evaluate specific scenarios with the assistance of counsel.

Please contact a Jackson Lewis attorney if you have any questions.