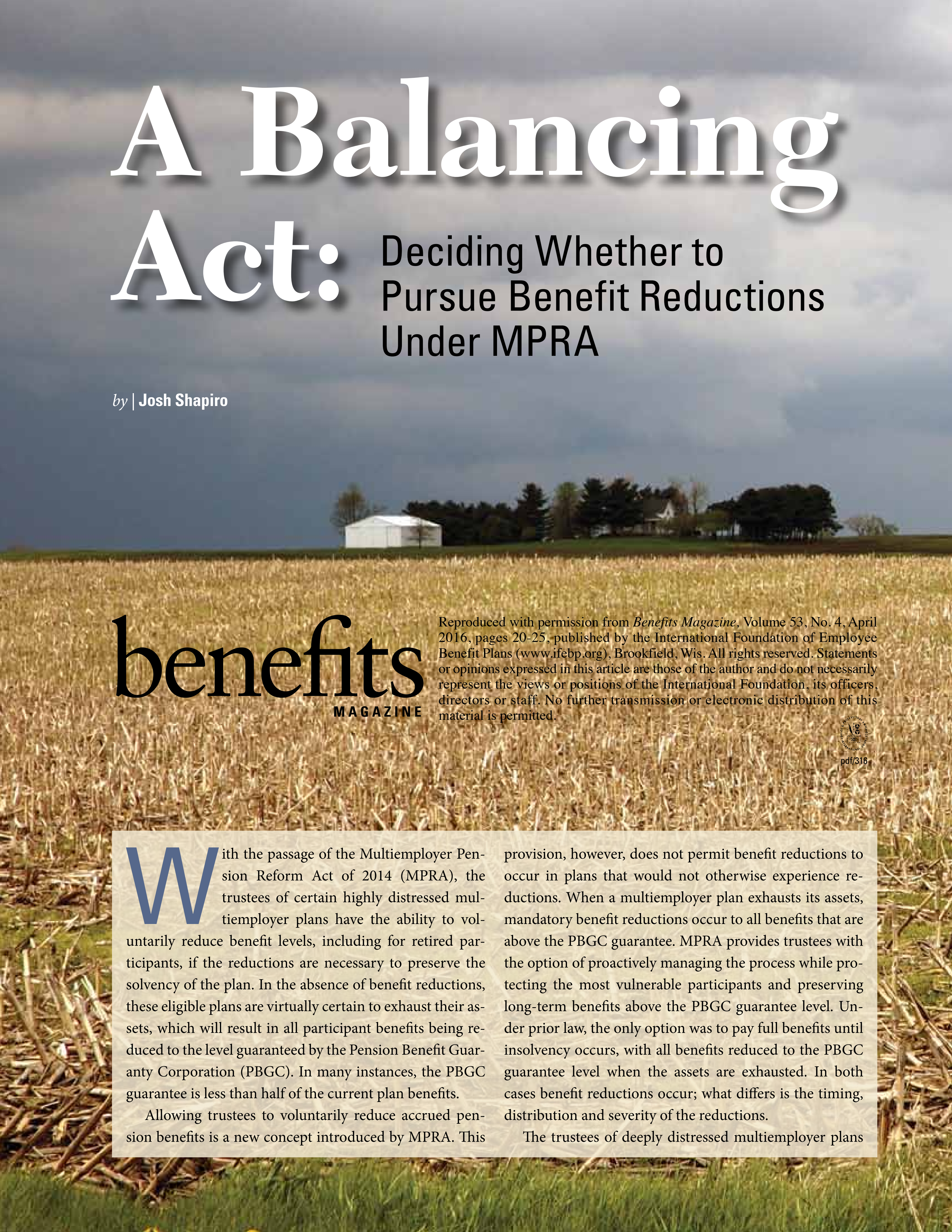

A Balancing Act: Deciding Whether to Pursue Benefit Reductions Under MPRA

by | **Josh Shapiro**

With the passage of the Multiemployer Pension Reform Act of 2014 (MPRA), the trustees of certain highly distressed multiemployer plans have the ability to voluntarily reduce benefit levels, including for retired participants, if the reductions are necessary to preserve the solvency of the plan. In the absence of benefit reductions, these eligible plans are virtually certain to exhaust their assets, which will result in all participant benefits being reduced to the level guaranteed by the Pension Benefit Guaranty Corporation (PBGC). In many instances, the PBGC guarantee is less than half of the current plan benefits.

Allowing trustees to voluntarily reduce accrued pension benefits is a new concept introduced by MPRA. This provision, however, does not permit benefit reductions to occur in plans that would not otherwise experience reductions. When a multiemployer plan exhausts its assets, mandatory benefit reductions occur to all benefits that are above the PBGC guarantee. MPRA provides trustees with the option of proactively managing the process while protecting the most vulnerable participants and preserving long-term benefits above the PBGC guarantee level. Under prior law, the only option was to pay full benefits until insolvency occurs, with all benefits reduced to the PBGC guarantee level when the assets are exhausted. In both cases benefit reductions occur; what differs is the timing, distribution and severity of the reductions.

The trustees of deeply distressed multiemployer plans

Whether a benefit reduction is in the best interest of plan participants, the timing of a reduction, how it would affect solvency and many other considerations must go into a trustee's decision to seek a benefit reduction under MPRA.

face a difficult and complex decision regarding the use of the MPRA benefit reduction authority. The last thing any trustee wants to do is take benefits away from participants, particularly retirees and beneficiaries in payment status. But when faced with the prospect of much larger reductions down the road, it may be in the best interest of the majority of participants for trustees to intervene early by implementing lesser reductions now, as opposed to waiting for the inevitable failure of the plan to occur. Determining whether or not to pursue MPRA benefit reductions requires the consideration of many factors.

Impact of Insolvency on Participants

When considering the potential merits of the MPRA benefit reduction provisions, the trustees of a plan that is projected to become insolvent should first evaluate the impact insolvency would have on participants. All multiemployer plans are eligible to receive assistance from PBGC if they exhaust their assets, but the portion of plan benefits covered by the PBGC guarantee varies widely across plans.

The PBGC guarantee formula for multiemployer plans is weighted heavily toward lower benefit levels, which means insolvency results in greater benefit losses for participants with relatively high benefit levels than for participants with low benefit levels. For example, a participant with 30 years of service and a plan benefit of $1,200 per month has 82% of the plan benefit covered by the PBGC guarantee. If the benefit for this participant were twice this amount—$2,400 per month—only 45% of the plan benefit is covered by the PBGC guarantee.

As trustees consider whether reducing benefits under MPRA is in the best interest of participants, the degree to which the plan benefits are covered by the PBGC guarantee is an important consideration. In a plan where the PBGC guarantee represents a large portion of the plan benefits, the trustees might conclude that pursuing MPRA benefit reductions is not in the best interests of the participants, since the insolvency of the plan would result in only a small benefit loss. The trustees of an otherwise similar plan where the PBGC guarantee represents less than half of the plan benefits might reach a very different conclusion.

An additional consideration is the ability of PBGC to support its guarantee into the future. The PBGC multiemployer insurance program is funded entirely with premiums paid by plans and, under current law, it cannot receive any financial support from the U.S. government. Recent estimates project that the PBGC multiemployer program is expected to be insolvent by 2025 and the unfunded liabilities of the program to exceed $50 billion. Should the multiemployer program fail and there is no taxpayer bailout, the PBGC multiemployer guarantee would be reduced to almost nothing. Trustees who are considering the impact that the insolvency of their plans will have on participants need to factor in the possibility that the current PBGC guarantee might not exist in the future, which places participants at risk of losing their benefits nearly in their entirety.

Eligibility Criteria

To reduce benefits under MPRA, plans generally need to be projected to fully exhaust their assets within 20 years. This requirement represents a very serious level of funding distress. In fact, the majority of multiemployer plans in critical status currently are ineligible for MPRA benefit suspensions because they are too well-funded to qualify.

Also, plans are able to reduce benefits under MPRA only if the plan actuary certifies that the proposed reductions are sufficient to eliminate the projected insolvency. This requirement is especially important because there are statutory limitations on the benefits that plans can reduce under MPRA.

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These limitations prevent plans from applying any reductions to participants over the age of 80 or to participants receiving disability benefits and also prohibit any reductions that would result in a participant receiving less than 110% of the amount guaranteed by PBGC.

The combination of (a) the limits on the benefits that plans can reduce and (b) the requirement that plans must be projected to remain solvent with the reductions means that not all plans that are projected to be insolvent within 20 years are able to use this provision. Plans that will still be projected to be insolvent even if they were to implement the maximum permissible level of suspensions are effectively prohibited from using the MPRA benefit reduction provisions. Just as there are many critical status plans that are ineligible to reduce benefits under MPRA because they are projected to be solvent for more than 20 years, on the other end of the spectrum are many critical status plans that are ineligible to reduce benefits because even the maximum permissible reductions are insufficient to prevent insolvency.

These eligibility criteria effectively create a window of time during which plans have the ability to reduce benefits under MPRA. When a plan is first determined to be headed for insolvency, it may be ineligible for this provision because the projected insolvency is more than 20 years into the future. Once enough time passes and the projected insolvency is within 20 years, the window opens and the plan becomes eligible for benefit reductions. From that point, as the projected date of insolvency continues to get closer, the level of benefit reduction necessary to prevent insolvency increases. Once this level exceeds the maximum reductions permissible under MPRA, the window closes and the plan ceases to be eligible to reduce benefits. At this point, the insolvency of the plan likely becomes inevitable, which means all benefits will be cut to the PBGC guarantee level.

Impact of Reductions on Participants

Once a plan concludes it is eligible to reduce benefits under MPRA, the most important question becomes whether taking that action serves the best interests of plan participants. The answer depends heavily on the magnitude of the benefit reductions that are necessary to prevent insolvency. All else being equal, trustees are more likely to conclude that preserving the solvency of the plan with a 15% average benefit reduction better serves the interests of participants than if the necessary reduction were 45%.

The simplest way to look at this question is to determine the total benefits projected to be paid to all plan participants both with and without the benefit reductions. In general, more benefits will be paid if benefits are reduced under MPRA. This is because all reduced benefits must remain at least 10% above the PBGC guarantee, and extending the solvency of the plan expands the length of time over which participating employers will make contributions and allows additional time for the plan assets to earn investment return. When evaluating participants' best interests in the aggregate, the plan sponsor needs to consider whether the additional benefits the plan will be able to pay over the long term are sufficient to justify the short-term failure of the plan to provide all of the promised benefits that participants expect to receive.

MPRA permits reductions only to the extent that they are necessary to eliminate the projected insolvency of the plan and prohibits any reductions beyond that point. The aggregate amount of benefit suspensions that is necessary for a plan to remain solvent depends heavily on the length of time until insolvency is projected to occur. The further a plan is from insolvency, the smaller the necessary aggregate benefit reductions are likely to be. As time passes, the level of reductions increases.

For plans that are considering implementing MPRA benefit reductions, the timing of those reductions is extremely important. For example, a plan might be able to avoid insolvency with a 20% reduction implemented today, and trustees could conclude that this action serves the best interest of participants. But if implementation of the reductions is delayed by several years, the amount necessary to save the plan might increase from 20% to 40%, and the trustees could then conclude that it would not be reasonable to implement this larger level of reduction. In this instance, the opportunity to act in the best interest of participants by preserving long-term benefits has been missed.

Ability to Develop an Equitable Distribution of Reductions

While the aggregate amount of benefits that need to be reduced under MPRA is determined largely by the financial condition of the plan, trustees have wide latitude in deciding how to distribute benefit suspension across the plan population. In deciding whether adopting suspensions serves the

takeaways

- As they consider whether to seek a benefits reduction under MPRA, trustees should first evaluate the impact insolvency would have on participants.
- The majority of multiemployer plans in critical status currently are ineligible for MPRA benefit suspensions because they are too well-funded to qualify.
- Plans projected to be insolvent even with the maximum permissible level of suspensions also are prohibited from using MPRA benefit reduction provisions.
- Eligibility criteria effectively create a window of time during which plans can reduce benefits under MPRA.
- A decision about whether benefit reductions under MPRA best serve plan participants depends on the magnitude of the reductions necessary to prevent insolvency.
- Trustees have wide latitude in deciding how to distribute benefit suspension across the plan population.
- The timing of reductions is important; trustees who wait too long may find that the percentage of reductions required has become unreasonable. Trustees will have missed the chance to preserve long-term benefits.

best interests of participants, trustees will need to consider the extent to which it is possible for a benefit reduction program to treat participants equitably.

Inevitably, benefit reductions will cause some participants to receive less than they otherwise would have. In simple terms, the trustees need to decide if the reductions will do more good than harm. This determination considers not only the amount of benefits that will be lost or preserved for different participant groups but also the specific circumstances of the groups that are likely to be better or worse off if the reductions are implemented.

MPRA identifies certain categories of vulnerable participants who are fully exempt from voluntary benefit reductions. These include participants over the age of 80 (with partial protection applying to participants who are aged 75 and older but younger than aged 80), those who are receiving disability benefits and those whose current plan benefit is at or below 110% of the amount guaranteed by PBGC.

The participants in these vulnerable groups are necessarily better off if the plan implements reductions, as their benefits are exempt from reduction, while the reductions applied to other participant groups will make the future insolvency of the plan less likely. Since the participants protected under MPRA would generally be subject to reduction in the event that the plan actually does become insolvent, they are all better protected if the plan voluntarily implements reductions.

Active participants, terminated participants and younger retirees also are likely to be better off if the trustees implement benefit reductions. To illustrate why this is true, consider a plan that is projected to be insolvent in ten years. Implementing benefit reductions and preventing insolvency will result in decreased benefit payments for the next ten years and increased benefit payments after ten years. Participants who are currently active, terminated or recently retired are likely to receive many years of payments more than ten years in the future and therefore are likely to be better off if the trustees adopt the reductions.

Active, terminated and recently retired participants also are the most likely to have been affected by the remediation measures trustees took to improve funding levels prior to considering MPRA benefit reductions. For most plans, these measures consisted of higher contribution rates, reduced levels of benefit accrual and cuts to subsidized early retirement benefits. These measures typically affected only participants who were not retired when the measures were implemented. This means they represent sacrifices made by participants who are currently active or terminated or who are now retired but were not yet in payment status when the remediation measures were adopted. While these participants are likely to be better off if the plan reduces benefits under MPRA, they also are likely to have had large sacrifices imposed on them in the past.

The participants who are most likely to be worse off when a plan implements benefit reductions are retirees who are younger than aged 80 but old enough so that the majority of their benefits will be paid before the plan becomes insolvent. For example, a 75-year-old retiree in a plan that is projected to be insolvent in ten years would be expected to receive most of his benefit payments before the plan becomes insolvent. This participant, therefore, is unlikely to be better off if the plan prevents insolvency by reducing benefits now. It is also true that participants in this group are unlikely to have been affected by the past measures the plan has taken to improve its funded position, as many of them already would have been retired when these measures were adopted.

When deciding whether benefit reductions under MPRA are in the best interests of participants, trustees need to determine if it is possible to design an approach that considers the circumstances of different participant groups in an equitable manner and complies with the various statutory requirements.

Cost Versus Likelihood of Success

As plans weigh the advantages and disadvantages of pursuing benefit reductions under MPRA, they also need to balance the potential benefits to plan participants against the costs that would be incurred and the possibility that the effort to implement reductions might fail. The process of developing a benefit reduction plan and submitting an application to the Department of Treasury is difficult, complicated and expensive. The plans that would consider taking this action have limited resources, and every dollar spent on this process represents money that no longer is available to pay benefits. This is an especially significant issue for smaller plans where administrative expenses already are likely to be relatively large in relation to the benefit payments.

As of the writing of this article, the Treasury regulations governing most aspects of the application process remain in proposed form, and only two applications for benefit reductions have been submitted, with no indication from the regulators on the probability of those applications being approved or rejected. The lack of final guidance and experience of past applications makes it difficult for a plan to make an informed judgment regarding the likelihood of Treasury approving an application. If Treasury does approve an application, it generally still needs to survive a vote by plan participants, which adds an additional layer of uncertainty to the outcome.

Lastly, the proposed Treasury regulations require that plans leave very little margin for error in designing benefit reductions under MPRA. In determining the level of reductions necessary to prevent the plan from becoming insolvent, the plan actuary must make a series of assumptions about future events such as investment returns and employer contributions. Under the proposed regulations, the reductions must be designed such that if future experience is even slightly less favorable than the actuary expects, the reductions will be insufficient to prevent the insolvency of the plan. On the one hand, the proposed regulation ensures the reductions are kept to the smallest possible level. On the other hand, because of the way actuaries do their calculations and how the proposed Treasury regulations work, this means there is approximately a 50% chance that they will not be large enough to prevent the failure of the plan.

Conclusion

For a multiemployer plan on a path toward inevitable insolvency, whether to pursue benefit reductions under MPRA is probably the most difficult decision the trustees have ever faced. Reducing benefits will cause hardship and suffering among plan participants. But when reductions already are certain to occur, a careful analysis of many factors may lead trustees to conclude that voluntarily reducing benefits before insolvency occurs provides the best possible solution to an extraordinarily difficult problem.

bio

Josh Shapiro is a senior actuarial advisor at Groom Law Group, Chartered. His practice focuses on the design, funding and administration of multiemployer, single employer and governmental retirement plans. Shapiro's experience includes working with a wide range of organizations to ensure that their retirement programs meet their financial and human resources objectives while complying with the applicable laws and IRS, PBGC and DOL regulations. Shapiro previously was the deputy director for research and education at the National Coordinating Committee for Multiemployer Plans. In this role, he was a principal member on the team that spearheaded the legislative effort that resulted in the passage of MPRA. Shapiro earned a bachelor's degree in mathematics from Cornell University. He is a fellow of the Society of Actuaries, a member of the American Academy of Actuaries and an enrolled actuary. He is the vice chairman of the Pension Practice Council of the American Academy of Actuaries.