Impact of Economic Downturn on Retirement Plans
Part II – Single Employer Defined Benefit Pension Plans

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Agenda

- Plan Operations
- Plan Administration
- Fiduciary Matters

Plan Operations – General Issues

- Suspension of employment – furlough, leave of absence or layoff of a temporary nature is not a severance of employment
  - Impacts eligibility to participate, to accrue benefits and vesting
    - Elapsed time plans
    - Hours of service plans
  - Contributions
    - Unpaid leave – might not accrue benefits, which could affect following year's funding calculations
  - Compensation definition in plan may or may not include certain payments to employees

Plan Operations – General Issues

  - Distributions – Most plans do not give participants access to their benefits until their employment terminates.
- Permanent termination of employment – layoffs and reductions in force
  - Payment requests must be processed
  - Partial plan terminations - one or a series of layoffs affects 20% or more of the workforce; full vesting of terminated participants to the extend plan is sufficiently funded (under ERISA)

Plan Operations – Plan Provisions

- In-service withdrawals and loans
  - Although rare, DB plans may permit age 59½ in-service withdrawals (SECURE Act) and loans against accrued benefit (up to lesser of 50% of vested accrued benefit and $50,000
    - In-service withdrawals - Post-retirement income will be reduced to pay short-term needs, potentially straining finances upon retirement, and income taxes will be owed on the distribution for the year in which received

Plan Operations – Plan Provisions

- Loans – Existing loans must continue to be repaid, and participants might not recognize negative implications of taking new loans
  - Initial issuance and annual fees
  - Repayments are made from after-tax amounts
  - Potential taxes and penalties if default or miss repayments
  - If not repaid, benefits intended to provide post-retirement income will be reduced to pay short-term needs, potentially straining finances upon retirement
- CARES Act expands availability of in-service distributions and modifies loan rules
  - Unclear whether these options are intended to apply to DB plans (by their terms they do)
  - Consider options when further guidance is available

Plan Operations – Plan Provisions

  - Employer can amend its plan document and/or loan policy to add flexibility to its loan program, such as allowing additional loans, or to add in-service distributions, subject to various restrictions
- Requirements for benefit accruals
  - Length of employment suspensions can affect participants' benefit accruals and/or vesting service

Plan Operations – Plan Provisions

- Freeze pension plan
  - "Soft freeze" – No new participants; can continue or discontinue benefit accruals for current participants, and if discontinued can still increase as compensation increases in the future.
  - "Partial freeze" – Benefit accruals continue only for specified groups of current participants.
  - "Hard freeze" – All benefit accruals are discontinued and determined using compensation at freeze date.

Plan Operations – Plan Provisions

- Must provide notice to participants and other individuals before the freeze takes effect
- Cannot take away benefits that have already accrued
- A freeze provides limited short term relief, but may provide longer term relief by containing future pension costs.
- Changes to collectively-bargained plans may need to be negotiated with union

Plan Operations – Plan Provisions

- Terminate pension plan
  - Standard termination: benefits must be made 100% vested, and sponsor must fully fund those benefits.
  - A majority owner may elect to forego all or a portion of his/her benefit if funding is an issue
  - Company can seek assistance from the PBGC to limit benefits to guaranteed amount if funding is an issue, or seek a hardship termination (see below)
  - Changes to collectively-bargained plans may need to be negotiated with union

Plan Operations – Plan Provisions

- Participants must be provided various notices regarding the termination (IRS and PBGC)
- Termination process can take one to two years

Plan Operations – Plan Amendments

- Plan amendments will be required to reflect plan operations.
  - If modifying existing plan provisions, amendments are generally required by the last day of the plan year.
  - In some cases the timing to adopt amendments may be extended; for example, the deadline to adopt amendments for the CARES Act changes will be the last day of the first plan year beginning on or after January 1, 2022.

Plan Administration

- Treasury Dept, IRS and Labor Dept have authority under Code Section 7508A and the disaster relief provisions in Rev. Proc. 2018-58 and can extend deadlines for required administrative filings, including:
  - Form 5500, Annual Return/Report, automatically extend deadline without filing Form 5558

Plan Administration

- Extend Form 1099-R e-filing deadline for employers (was March 31, 2020)
- Note: the deadline to restate defined benefit plans has been extended 3 months from April 30, 2020 to July 31, 2020

- For plans covered by the PBGC's insurance program, reporting and disclosures may be required
  - Premium payments must continue (PBGC Form 1)

Plan Administration

- Reportable events filings (PBGC Form 10 or PBGC Form 10-Advance) may be required for, among other reasons
  - Active participant reduction
  - Failure to make required funding payments
  - Application for minimum funding waiver
  - Inability to pay benefits when due
  - Total underpayments, with interest, exceed $1 million (PBGC Form 200)

Plan Administration

- Reportable “4062(e) event”
  - Company permanently ceases operations at a facility that results in a workforce reduction of more than a 15% reduction in the total number of employees eligible to participate in any defined benefit or defined contribution plan maintained by members of the same controlled group
  - Company may be required to notify PBGC
  - Company can make additional annual contributions for seven years to fund the benefit liability
  - Company can request a funding waiver from the Internal Revenue Service

Plan Administration

  - Plans not subject to PBGC coverage include “professional” plans with fewer than 25 participants (doctors, lawyers, etc.), substantial owner plans and certain church plans
- Required notices to participants, beneficiaries and alternate payees
  - Future benefit accruals will be significantly reduced by a plan amendment
  - Employer requests a waiver of the minimum funding requirement
  - Employer fails to make a minimum required contribution

Plan Administration

- The plan becomes subject to benefit restrictions due to funding status
- The plan is terminating

Plan Administration – Funding Status

- Funding status
  - Investment changes are not likely to have an immediate impact on a plan's funding requirements because contribution requirements are calculated only once each year on the actuarial valuation date, which is usually the first day of the plan year (typically January 1). Therefore, daily or monthly volatility does not immediately impact most pension plans; the important date to assess the impact on the assets is on the valuation date

Plan Administration – Funding Status

- Funding rules allow for actuarial asset values to be smoothed over a 24-month period, which dampens the volatility of a funding shortfall and the minimum required contribution
- Lower interest rates may cause pension liabilities and expenses to remain higher for a longer period of time
- Congress could pass additional funding relief that could mitigate cash pains over the next few years

Plan Administration – Funding Status

- CARES Act provides funding relief for single employer defined benefit plans:
  - Due date for minimum required contributions otherwise due during 2020 may be delayed until January 1, 2021, at which time 2020 contributions plus interest will be due.
    - Interest accrues from the original payment due date through the actual payment date using the effective rate of interest for the plan for the plan year which includes such payment date.

Plan Administration – Funding Status

  - Note that companies obligated to make contributions under a collective bargaining agreement or by the terms of an agreement with the Pension Benefit Guaranty Corporation may be unable to delay such contributions

- Plan sponsors may choose to use the plan's funded status for the last plan year ending before January 1, 2020 for purposes of determining the funding-based benefit restrictions for plan years that include calendar year 2020 to avoid restrictions on future benefit accruals and optional forms of distribution due to a decline in funding status

Plan Administration – Additional Issues

- Temporary business hardship - company can request a funding waiver from the IRS
  - Company can skip the minimum funding contribution for a year and make repayments over the following five years.
  - IRS can grant a waiver for up to three of any 15 consecutive plan years

Plan Administration – Additional Issues

- The PBGC may proactively contact a company for more information if funding contributions are missed. If a payment plan cannot be arranged to make up the missed contributions, the PBGC may initiate an involuntary plan termination
- A company can request PBGC approval of a distress termination if the plan is covered by the PBGC's insurance program. The PBGC reviews historical and projected financial information and determine whether the company satisfies one of ERISA's tests for distress

Plan Administration – Additional Issues

- Companies facing bankruptcy or liquidation or that participate in multiemployer plans have additional challenges that are beyond the scope of this outline

Plan Administration – Funding Status

- Account reviews
  - Plan administrators should ask investment advisers to review the assets
    - Short and long term risks
    - IPS review
    - Valuations and impact on NAV, performance
    - Liquidity Needs – lack of market liquidity, investor redemption
    - Adviser conflicts –adviser handling of proprietary product and affiliated investment advisers
    - Review any new adviser disclosures or information carefully

Fiduciary Matters – Plan Administration

- Maintain a mechanism for plan administration, especially through remote working conditions
  - Administrative committees, boards of directors still need to be able to act and respond to immediate needs
  - Signature authority needs to be vested in more than one individual for flexibility
  - Systems access, procedures and methodologies need to be maintained
  - Service providers should be monitored to ensure they offer appropriate guidance and advice

Fiduciary Matters – Plan Investments

- Critically important: Continue to monitor investment performance and seek advice regarding prudent actions to take
  - Properly document steps taken by fiduciaries to monitor the situation and to determine whether and what actions should be taken, if any

Fiduciary Matters – Plan Investments

- Understand investments in employer stock or real property may see greater valuation fluctuations than the general market or investment fund
  - Publicly traded employer stock may receive relief from the Supreme Court
  - Closely held companies generally do not have a market to buy and sell shares, so it can be harder to make investment changes

Fiduciary Matters – Who Are the Fiduciaries?

- Confirm how fiduciary responsibility is allocated, monitored and supervised among the broad fiduciary categories of
  - investment / plan management, and
  - administration
- Beware of becoming a functional fiduciary
- Review ERISA bond and fiduciary insurance

Conclusion

We do not know what the long term prospects are for the economy. Certainly the current and expected degradation in economic growth will impact defined benefit pension plans and their participants in the short term, but the severity of the virus and how effectively it can be contained will have a significant bearing on the timing of any recovery.

Important Information

This presentation is intended for general informational purposes only, and it does not constitute legal, tax or investment advice from The Wagner Law Group. Consult with legal counsel to understand the nature and scope of the responsibilities under ERISA and other applicable law.

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