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

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The current volatility in the economy due to the coronavirus pandemic has created various issues for retirement plans that need to be addressed in an expedited and efficient manner. The impacts on single employer defined benefit pension plans can be categorized into three broad areas: day-to-day plan operations, plan administration and fiduciary matters. Each of these categories has a range of considerations which are outlined below, but note that while many of these considerations are important for multiemployer plans and sponsors in bankruptcy or liquidation, those topics are beyond the scope of this outline.

1. Plan operations.
   a. General Issues:
      i. Suspension of employment –A furlough, leave of absence or layoff of a temporary nature generally would not be considered a severance from employment.
         A. Impacts on eligibility to participate and to accrued benefits, and vesting.
            I. In elapsed time plans, an employee is credited with periods of service, which generally means the employee must be employed at the beginning and end of a specified period (not more than 12 months) or for a specified period of time.
            II. In hours of service plans, an employee generally must be credited with a specified number of hours of service during a measurement period. Hours of service are credited for actual hours for which the employee is paid or entitled to payment.
         B. Contributions – Employer's obligation to make funding contributions is generally determined on an annual basis; unpaid leave means participants might not accrue benefits, which could affect the following year's funding calculations (but note the discussion of the CARES Act below).
         C. Compensation is a defined term in a plan, and the definition may or may not include certain payments to employees.
         D. Distributions – Most plans do not give participants access to their benefits until their employment terminates.
      ii. Permanent termination of employment – Layoffs and reductions in force.
         A. Payment requests from participants will have to be processed.

B. Partial plan terminations may occur if one or a series of layoffs affects 20% or more of the workforce, in which case terminated participants will have to be made fully vested to the extent the plan is sufficiently funded (using ERISA's ordering of payment priority).

b. Plan Provisions

i. In-service withdrawals and loans – Although rare, defined benefit pension plans may offer in-service withdrawals to participants as early as age 59½ (under the SECURE Act) and permit participants to take loans against their accrued benefits up to the lesser of 50% of their vested accrued benefit and $50,000.

A. In-service withdrawals – Benefits intended as 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 it is received.

B. Loans - Existing loans must continue to be repaid, and participants might not recognize negative implications of taking new loans:

I. Initial issuance and annual fees;

II. Repayments are made from after-tax amounts;

III. Potential taxes and penalties if default or miss repayments; and

IV. If not repaid, benefits intended to provide post-retirement income will be reduced to pay short-term needs, potentially straining finances upon retirement.

C. The CARES Act expands the availability of in-service distributions and modifies the loan rules that apply to qualified retirement plans generally. However, it is not clear whether these CARES Act options are intended to apply to defined benefit plans; because of the limited availability from most defined benefit plans of in-service distributions and loans, these options may be considered when further guidance is available.

D. An 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.

ii. Requirements for benefit accruals – The length of employment suspensions can affect participants' benefit accruals and/or vesting service.

iii. A company can freeze its pension plan.

A. "Soft freeze" - New employees are stopped from becoming participants. Benefit accruals for current participants can be continued, or they can be discontinued but can still increase as compensation increases in the future.

B. "Partial freeze" - Benefit accruals can be continued for specified groups of current participants and discontinued for other groups.

C. “Hard freeze” – All benefit accruals for all participants are discontinued and benefits are determined based on compensation as of the freeze date.

D. A notice must be provided to participants and other individuals before the freeze takes effect.

E. Benefits that have already accrued cannot be taken away.

F. Note that freezing a pension plan will provide limited short term relief, but may provide longer term relief by containing future pension costs.

G. Also note that a company may be constrained from making changes to a collectively-bargained plan based on the collective bargaining agreement.

iv. A company can terminate its pension plan.

A. In a standard termination, benefits must be made 100% vested, and sponsor must fully fund those benefits.

B. If fully funding the plan is an issue, a majority owner may elect to forego all or a portion of his/her benefit.

C. A company may be constrained from terminating a collectively-bargained plan based on the collective bargaining agreement.

D. If full funding is an issue, company can seek assistance from the PBGC to limit benefits to guaranteed amount or in a hardship termination (see below).

E. Participants must be provided various notices regarding the termination.

F. Following all of the notice and timing requirements to terminate a pension plan can take one to two years.

c. Plan amendments will be required to reflect plan operations. If modifying existing plan provisions, amendments may be required before modification takes effect; otherwise 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.

2. Plan administration.

a. Treasury Department, IRS and Labor Department have regulatory authority under Code Section 7508A and the disaster relief provisions in Rev. Proc. 2018-58 and can extend deadlines for required administrative filings, including:

i. Form 5500, Annual Return/Report, automatically extend deadline without filing Form 5558.

ii. Extend Form 1099-R e-filing deadline for employers (was March 31, 2020).

iii. Note: the deadline to restate defined benefit plans has been extended three months, from April 30, 2020 to July 31, 2020.

b. For plans covered by the PBGC's insurance program, reporting and disclosures may be required.
   i. Premium payments must continue (PBGC Form 1).
   ii. Reportable events filings (PBGC Form 10 or PBGC Form 10-Advance) may be required for, among other reasons:
      A. Active participant reduction;
      B. Failure to make required funding payments;
      C. Application for minimum funding waiver; and
      D. Inability to pay benefits when due.
      E. Total underpayments, with interest, exceed $1 million (PBGC Form 200).
   iii. Reportable "4062(e) event."
      A. A "4062(e) event" occurs if a 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.
      B. Company may be required to notify PBGC.
      C. The company can elect to make additional annual contributions for seven years to fund the benefit liability.
      D. The company can request a funding waiver from the Internal Revenue Service.
   iv. Plans not subject to PBGC coverage include "professional" plans with fewer than 25 participants (doctors, lawyers, etc.), substantial owner plans and certain church plans.

c. Required notices to participants, beneficiaries and alternate payees.
   i. Future benefit accruals will be significantly reduced by a plan amendment.
   ii The employer requests a waiver of the minimum funding requirement.
   iii. The employer fails to make a minimum required contribution.
   iv. The plan becomes subject to benefit restrictions due to funding status.
   v. The plan is terminating.

d. Funding status.
   i. Investments –
      A. 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.
      B. 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.

C. Lower interest rates may cause pension liabilities and expenses to remain higher for a longer period of time.

D. Congress could pass additional funding relief that could mitigate cash pains over the next few years.

ii. The CARES Act provides funding relief for single employer defined benefit pension plans.

A. The due date for minimum required contributions otherwise due during 2020 may be delayed until January 1, 2021, at which time the 2020 contributions plus interest will be due.

I. 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.

II. 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.

B. 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.

iii. Account reviews – Plan administrators should ask the investment advisers to review the assets.

A. Short and long term risks

B. IPS Review

C. Valuations and impact on NAV, performance

D. Liquidity Needs – lack of market liquidity, investor redemption

E. Adviser conflicts – adviser handling of proprietary product and affiliated investment advisors

F. Review any new adviser disclosures or information carefully ,

d. Additional issues

i. A company facing a temporary business hardship can request a funding waiver from the IRS, which permits the company to skip the minimum funding contribution for a year and make repayments over the following five years. The IRS can grant a waiver for up to three of any 15 consecutive plan years.

ii. 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, depending on the facts and circumstances, initiate an involuntary termination of the plan to protect the plan and its participants.

iii. A company facing more serious financial hardship can request that the Pension Benefit Guaranty Corporation ("PBGC") approve a distress termination of a pension plan if the plan is covered by the PBGC's insurance program. The PBGC will review historical and projected financial information and determine whether the company satisfies one of the tests under ERISA.

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

3. Fiduciary matters.

a. Plan administration – It is important to maintain a mechanism for plan administration, especially through remote working conditions.

i. Administrative committees, boards of directors still need to be able to act and respond to immediate needs.

ii. Signature authority needs to be vested in more than one individual for flexibility.

iii. Systems access, procedures and methodologies need to be maintained.

iv. Service providers should be monitored to ensure they offer appropriate guidance and advice.

b. Plan investments – It is critical to continue to monitor investment performance and seek advice regarding prudent actions to take.

i. Properly document steps taken by fiduciaries to monitor the situation and to determine whether and what actions should be taken, if any.

ii. Understand investments in employer stock or real property may see greater valuation fluctuations than the general market or investment fund.

A. Publicly traded employer stock may receive relief from the SEC.

B. Closely held companies generally do not have a market to buy and sell shares, so it can be harder to make investment changes.

c. Who are the fiduciaries?

i. Confirm how fiduciary responsibility is allocated, monitored and supervised among the fiduciary categories of (A) investment / plan management and (B) administration

ii. Beware becoming a functional fiduciary

iii. Review ERISA bond and fiduciary insurance to ensure appropriate coverage

We don't 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.