Publications

PBGC Issues Final Regulation for Multiemployer Plans Applying for Special Financial Assistance

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On July 8, 2022 the Pension Benefit Guaranty Corporation ("PBGC") published its final regulation implementing the Special Financial Assistance ("SFA") program for multiemployer pension plans under the American Rescue Plan Act ("ARPA"). Plans have been operating under an interim final rule since July 9, 2021, and to-date 27 plans have received SFA in accordance with that regulation.

The final regulation generally follows the same framework as the interim final regulation, but there are some significant and substantive changes. These changes will increase the amount of SFA that many plans will be eligible to receive, and will also affect how plans operate after they have received SFA.

Plans that receive SFA before the August 8, 2022 effective date of the final regulation, and that are eligible for a larger amount of assistance under the final regulation, may file supplemented applications in order to access the additional relief. Plans that have pending applications on that date may withdraw their applications and resubmit them under the final regulation. If a plan does not withdraw a pending application that is subsequently approved, the amount of SFA it receives will be calculated under the interim final rule, but the plan may file a supplemented application under the final rule at a later date.

The final regulation contains important changes to the asset classes in which plans are permitted to invest SFA, and to how plans calculate withdrawal liability after receiving SFA. If a plan receives or received SFA under the interim final regulation, it does not become subject to these changes until after it files a supplemented application. Plans that receive SFA under the interim final regulation and that are not eligible for any additional SFA under the final regulation must still file supplemented applications in order for the new investment allocation and withdrawal liability provisions to apply to them.

Plans may submit supplements to approved SFA applications starting on August 8, 2022, and the filing window for supplemented applications will close on December 31, 2026.

The following are the most notable changes from the interim final regulation to the final regulation, each of which is described in more detail below.

- Use of Separate Interest Rates for Projecting Existing Plan Resources and SFA
- Ability of Plans to Invest up to 33% of SFA in Return Seeking Assets and Updated Limitations on Investment Grade Fixed Income Securities
- Phase-in of SFA into Withdrawal Liability Calculations
- Increased SFA Available to Plans that Suspended Benefits under MPRA
- Changes to the Benefit Improvement and Contribution Reduction Restrictions that Apply after Plans Receive SFA
- Clarification of Restrictions Applicable to Mergers Occurring after Plans Receive SFA
- Ability of Plans to File Lock-in Applications

Use of Separate Interest Rates for Projecting Existing Plan Resources and SFA

In order to calculate the amount of SFA a plan is eligible to receive, it is necessary to project the plan's future investment returns. This projection includes the returns on the plan's existing assets, and the returns that the SFA will earn after the plan receives it. Under the interim final regulation, a single prescribed interest rate applied to the future investment returns on both of these asset pools. That rate was the lesser of (a) the interest rate used in the plan's most recent zone status certification prior to January 1, 2021, and (b) the 3rd segment rate from the single-employer funding rules (without regard to the interest rate stabilization provisions) plus 200 basis points. This rate has generally been around 5.3%.

Under the final regulation, separate prescribed interest rates apply to the plan's existing assets and the SFA. The rate that applies to the existing assets is the same rate that applied under the interim final regulation. The rate that applies to the SFA is the lesser of (a) the rate that applies to the existing plan assets, and (b) the average of the first, second, and third segment rates from the minimum funding rules (without regard to the interest rate stabilization provisions) plus 67 basis points. This rate has generally been around 3.0%.

Due to the lower projected rate of return on SFA assets, the amount of SFA that plans are eligible to receive will tend to be higher under the final regulation than under the interim final regulation. This effect will be most significant for plans that have relatively small amounts of existing assets, and will be less significant for plans that have larger amounts of existing plan assets. Another relevant factor is the plan's interest rate from the most recent pre-2021 zone status certification. The impact of the final regulation will be greatest when the interest rate from the zone status certification was above 5.3%, as is most often the case. When that rate was between 3.0% and 5.3% the change in the final regulation will tend to have a lesser effect, and there may be no effect when that rate was below 3.0%.

Ability of Plans to Invest up to 33% of SFA in Return Seeking Assets and Updated Limitations on Investment Grade Fixed Income Securities

The statutory language of ARPA requires that SFA "… shall be invested by plans in investment-grade bonds or other investments as permitted by the corporation [PBGC]". The PBGC's interim final regulation took a very conservative position requiring that all SFA must be invested in investment-grade fixed income assets, with a 5% sleeve for subsequently downgraded assets. A general description of permitted investment vehicles holding such assets was also included.

The final regulation, however, significantly expands the ability of plans to invest SFA in securities other than investment-grade corporate bonds, allowing up to 33% of SFA to be invested in "return-seeking assets" ("RSAs"). RSAs are defined as: (1) publicly-traded dollar-denominated common stocks; (2) shares in permissible fund vehicles with an investment policy that restricts investment predominately to publicly traded stock, U.S. Treasury securities with less than one year to maturity date, and certain cash or cash equivalents; (3) investment grade non-foreign issued debt securities resold in Rule 144A offerings; (4) originally investment grade debt securities that are downgraded.

Under the final regulation, the other 67% of SFA must be invested in certain investment-grade fixed income securities and cash ("IGFI"). The final regulation generally defines "investment grade" as "securities for which the issuer (or obligor) has at least adequate capacity to meet the financial commitments under the security for the projected life of the asset or exposure." The definition of IGFI limits those investments to bonds or other debt securities that pay a fixed amount or fixed rate of interest denominated in U.S. dollars and are sold in a registered offering, shares in a permissible fund vehicle, government securities listed on Form 5500 Schedule H, certain municipal securities, non-interest bearing and interest-bearing cash equivalents listed on Form 5500, and certain money market funds.

Unlike the interim regulation's more general definition of permissible fund vehicles in which SFA can be invested, the final regulation specifically lists the types of investment company or collective trusts that qualify as permissible fund vehicles. They include: (1) "an open-end investment company registered on Form N-1A under section 8 of the Investment Company Act of 1940"; (2) "a unit investment trust (as defined in section 4(2) of the Investment Company Act of 1940 and registered under section 8 of such Act) the shares of which are listed and traded on a national securities exchanged and that has been formed and operates under an exemptive order granted by the" SEC; and (3) "a collective trust fund that is maintained by a bank or trust company and that has been formed and operates pursuant to an exemption under section 3(c)(11) of the Investment Company Act of 1940." However, the final regulation prohibits such vehicles from including certain derivatives or leverage increasing risk associated with the asset's market value.

Finally, while all of the SFA and earnings must be segregated in an account separate from a plan's legacy assets, the plan fiduciaries may take the SFA asset classes into account when deciding the proper allocation for the plan's legacy assets. The final regulation also requires that a plan's fiduciary seek the advice of an experienced investor when determining whether SFA investments are actually investment grade.

Phase-in of SFA Into Withdrawal Liability Calculations

In the interim final rule, PBGC described that, although considered, receipt of SFA on a plan would not be conditioned on excluding the SFA from the value of plan assets for purposes of calculating employer withdrawal liability. Upon further consideration, PBGC observed in the final rule that, by including, rather than excluding, the SFA in the withdrawal liability analysis, the amount of unfunded vested benefits "would likely decline," meaning that employers could incur less withdrawal liability after a plan receives SFA. PBGC described a concern that, in this regard, immediately including the SFA in the asset base could "subsidize" employer withdrawals.

In order to address the potential subsidy and incentives that employers may have to withdraw after a plan receives SFA, the final rule conditions receipt of SFA on a plan phasing-in the recognition of the SFA over time for purposes of calculating withdrawal liability. The phase-in period generally begins with the first plan year in which the plan receives its SFA payment, and ends with the plan year in which the plan is projected to exhaust SFA assets. Note, there is a thirty-day public comment period on the phase-in of SFA into withdrawal liability calculations.

In addition to the phasing-in of SFA, the final regulation slightly modifies the rules regarding the interest rates used in withdrawal liability calculations. The interim final rule required that plans receiving SFA calculate withdrawal liability assessments using the PBGC prescribed interest rate assumption for mass withdrawals until the later of (a) 10 years after the end of the plan year in which the plan receives SFA or (b) the last day of the plan year in which the plan no longer holds SFA or earnings thereon. To address concerns that a plan could continue to hold *de minimis* amounts of SFA so as to continue using the PBGC mass withdrawal rates, the final rule was changed so that the second part of the text now references the plan year in which the plan projects to exhaust SFA. This projection assumes that benefits and expenses are paid exclusively from SFA until exhausted, and the period is extended by the number of years, if any, that the first plan year of SFA payment is after the plan year of the SFA measurement date.

The final regulation also clarifies that SFA is not counted as a receivable asset for the purpose of determining the unfunded vested benefits of a plan prior to the date on which the plan actually receives the SFA.

Increased SFA Available to Plans That Suspended Benefits Under MPRA

The final regulation provides a different methodology for determining the amount of SFA for plans that have suspended benefits under the Multiemployer Pension Reform Act ("MPRA"). Under the final regulation, a MPRA plan can apply for the greatest of: (1) the amount of SFA calculated for a plan that is not a MPRA plan; (2) the lowest amount of SFA that is sufficient to ensure that the plan will project rising assets at the end of the 2051 plan year; and (3) an amount of SFA equal to the present value of the suspended benefits that are reinstated, including make-up payments. The interim final regulation contained only the first of these amounts.

PBGC indicates in the preamble to the final regulation that the creation of this separate formula for calculating the SFA amount for MPRA plans was in response to comments to the effect that the trustees of MPRA plans were faced with an impossible choice between retaining the existing MPRA benefit suspensions, or applying for SFA but potentially jeopardizing the long-term financial health of the plan. By statute, the MPRA suspensions had to be sufficient to enable the plan to avoid insolvency indefinitely. In contrast, under the interim final rule, MPRA plans that receive SFA would reinstate all suspended benefits, but they would likely be projected to become insolvent before 2051.

The new, second part of the calculation determines the lowest amount of SFA necessary for actuarial projections to show the plan's assets are increasing as of the last day of the plan year ending in 2051, which corresponds to the MPRA requirement that a plan suspending benefits must be capable of avoiding insolvency indefinitely. The third part of the calculation is intended to respond to comments that MPRA plans should not receive less in SFA than the present value of the suspended benefits they will be required to restore.

Changes to the Benefit Improvement and Contribution Reduction Restrictions That Apply After Plans Receives SFA

Both the interim final regulation and the final regulation allow plans that receive SFA to prospectively increase their rate of benefit accrual, but only if the increase is supported by additional employer contributions. Both rules also prohibit plans that receive SFA from adopting any benefit improvements associated with participants' past years of service. These restrictions are in effect through 2051. Beginning 10 years after a plan receives SFA, the final regulation allows the plan to request that PBGC provide an exception to either or both of these restrictions.

Both the interim final regulation and the final regulation prohibit the reallocation of contributions from a plan that received SFA to another benefit plan. The final regulation, however, allows plans to apply for a limited exception beginning 5 years after the plan receives SFA.

Clarification of Restrictions Applicable to Mergers Occurring After Plans Receive SFA

Plans that receive SFA must request approval from PBGC before engaging in a merger, transfer of assets, or spinoff during the period between the SFA measurement date and the end of the plan year ending in 2051. The interim final regulation did not address how the restrictions applicable to a plan that receives SFA apply to a plan that either receives a transfer of assets and liabilities from a plan that has received SFA, or merges with a plan that has received SFA.

Under the final regulation, all restrictions that apply to a plan that receives SFA also apply to a plan that receives a transfer of assets and liabilities from a plan that has received SFA. In the case of a merger involving a plan that has received SFA, the merged plan is generally subject to the same restrictions that apply to plans receiving SFA, with certain exceptions. The most notable of these exceptions are:

- The ability of the merged plan to adopt prospective benefit increases is not restricted.
- The restrictions related to retrospective benefit improvements, contribution decreases, and reallocations of contributions, apply to the merged plan, but only with respect to participants and employers associated with the pre-merger plan that received SFA.
- The merged plan must use PBGC mass withdrawal interest rates for calculating withdrawal liability assessments, but only with respect to liabilities that arose under the plan that received SFA.

When requesting PBGC approval for a merger, if certain criteria are satisfied plans may request waivers of the restrictions related to retrospective benefit improvements, contribution decreases, and reallocations of contributions.

Ability of Plans to File Lock-in Applications

The interim final regulation established a priority category system under which plans facing different levels of distress become eligible to apply for SFA at different times. It is possible that this priority system notwithstanding, PBGC may temporarily cease accepting applications because the volume of applications is higher than PBGC can reasonably process within the required timeframe. The final regulation did not make any changes to the priority categories, but it did provide plans with the ability to file a “lock-in application” in the event PBGC temporarily ceases accepting applications. Lock-in applications are only available to plans that are eligible to apply for SFA under the priority category framework, but are unable to do so because PBGC has temporarily ceased accepting applications. Most notably, filing a lock-in application would establish the SFA measurement date, census data, and the prescribed interest rates for the plan’s SFA application. The application process could then proceed when PBGC resumes accepting applications, but these components of the application would not be reset, as they were permanently established when the plan submitted the lock-in application.