The Nitty-Gritty of Pension Plan Mergers

Scott D. Newsom
Partner
Shumaker, Loop & Kendrick, LLP
Toledo, Ohio

Mike R. Rust, ASA, EA, MAAA
President
Cuni, Rust & Strenk, Inc.
Cincinnati, Ohio

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Topics

• Searching for a partner
• Practical issues in exploring a merger
• Dealing with withdrawal liability issues
• Ways to respond to unfavorable projections
• Fiduciary considerations
Searching for a Partner

- Ideal merger candidate
  - Same trade and geographic area
  - Similar funding levels and benefits
  - Share contributing employers
Searching for a Partner

- Wanted:
  - Pension plan that is 150% funded, doesn’t have withdrawal liability, actively invests its assets and always earns more than its benchmarks, and is begging for poorly funded plans to merge with it
If your plan is poorly funded, difficult to merge into well funded plan

- Poorly funded plan would need to be immaterial versus well funded plan
- Exception would be a Pension Benefit Guaranty Corporation (PBGC) facilitated merger
Searching for a Partner

• Poorly funded plan needs to fix its problems either before or after merger
• Much easier to merge with a plan that has similar Pension Protection Act of 2006 (PPA) funded status
Searching for a Partner

• PBGC will facilitate merger if:
  – It determines that merger is in the best interest of at least one of the plan’s participants
  – Not adverse to the overall interests of participants in any of the merged plans
Searching for a Partner

• PBGC facilitation may include:
  – Training and technical assistance
  – Mediation and communications
  – Support with other agencies

"The nine most terrifying words in the English language are: 'I'm from the government and I'm here to help.'"
   - Ronald Reagan
Searching for a Partner

• PBGC may provide financial assistance if:
  – At least one plan is critical and declining
  – $ PBGC provides up front is expected to reduce its future losses
  – PBGC certifies to Congress that its ability to meet future obligations is not impaired by up front payment
Searching for a Partner

- Critical and declining issue
  - Assume critical and declining plan has suspended benefits (note, as of the date these materials have been prepared, no plan has been allowed to suspend benefits)
  - Need clarification (from IRS/PBGC) that upon merger the suspended benefits are not restored
  - How does merged plan test if benefits still need to be suspended?
Practical Issues

- Multiemployer plan mergers must satisfy ERISA Section 4231
  - Notify PBGC of merger at least 120 days before the effective date of the merger
Practical Issues

• **ERISA Section 4231 (continued)**
  
  – No participant’s or beneficiary’s accrued benefit as of the merger date can be reduced
  
  – Benefits of participants and beneficiaries are not reasonably expected to be subject to suspension as defined under Multiemployer Pension Reform Act of 2014 (MPRA)
• ERISA Section 4231 (continued)
  – Actuarial valuation of the assets and liabilities of each of the affected plans has been performed during the plan year preceding the effective date of the merger, based on the most recent data available as of the day before the start of that plan year.
Practical Issues—Why Merge?

• Economies of scale
  – Administrative expenses (actual)
  – Investment fee reduction (actual)
  – Investment diversification (theoretical)
Practical Issues—
Why Merge?

• Contribution diversification
  – Employers who work in large area only need to send contributions to one plan
  – Reduces reciprocity issues for active participants
  – Facilitate locals that have merged
Practical Issues—Why Not Merge?

• Less local control (bigger not always better)
  – Union/Management may significantly disagree on this objective

• Is other plan willing to standardize benefits and contribution structure?
  – If not, one plan can end up subsidizing the other
  – Could negatively impact PPA status
  – Could expose employers to more withdrawal liability
Practical Issues—Future Benefits

• Consider a fully funded plan design for the merged plan
  – Section 414(k) Evergreen Plan™ or Variable Annuity Plan
  – Standardizes plan design and eliminates potential subsidies
  – Way to sign up new employers
Practical Issues—PPA

- Merger of green plans
  - Merged plan should also be green
- Merger of critical or endangered plans
  - Impact on rehabilitation or funding improvement plans
Practical Issues—PPA

• Merger of plans with different PPA status
  – Need to determine PPA status of merged plan
  – Develop new rehabilitation or funding improvement plans if necessary
Practical Issues—Due Diligence

• Actuarial
  – Prepare projections of merged plan with uniform actuarial assumptions
  – Determine potential cost savings

\[ f(x) = \frac{\Gamma(a + b)}{\Gamma(a)\Gamma(b)} x^a (1 - x)^b - \frac{1}{2} \]
Practical Issues—Due Diligence

• Legal
  – Review of plan document, trust agreement and plan amendments
  – Consideration of determination letters
  – Identification and correction of any document or operational errors
  – Pending or threatened litigation
Practical Issues—Due Diligence

- Legal
  - Required filing and communications to PBGC
  - Communications to participants
  - Development of merger agreement
  - Exchange of financial and operational information
Merger Agreement

- Agreement sets forth the terms
  - Number of trustees post merger
  - Transfer of assets and liabilities
  - Conditions to closing merger
  - Failure to merge
  - Representations and warranties
  - Future benefits and post closing operations
  - Dispute resolution
  - Tail fiduciary insurance
Withdrawal Liability Issues

- Only statutory requirement—ERISA Section 4211(f)—is that:
  - “if a withdrawal occurs in the first plan year beginning after a merger of multiemployer plans, the determination under this section shall be made as if each of the multiemployer plans had remained separate plans.”
Withdrawal Liability Issues

- If pre-merger plans have withdrawal liability then the merged plan will have withdrawal liability.
- If the pre-merger plans are construction trade plans then the withdrawal liability allocation method will be the presumptive method (non-construction trade plans means allocation method will need to be selected).
Withdrawal Liability Issues

• If the withdrawal allocation method is changed, then the plan’s contributing employers will need to be notified

NOTICE

The Pension Plan that your company contributes to is changing its withdrawal liability allocation method
Withdrawal Liability Issues

• Withdrawal liability actuarial assumptions will match those used for the merged plan’s funding actuarial valuation with the possible exception of the interest rate.

• 7th Circuit Court of Appeals has ruled that a multiemployer plan must use the actuaries best estimate assumptions to calculate withdrawal liability.
Withdrawal Liability Issues

Geographic Boundaries
of United States Courts of Appeals and United States District Courts
Withdrawal Liability Issues

• May continue to calculate withdrawal liability as if plans did not merge
  – More complex but could address concerns that less well funded plan’s employers may withdraw after plans are merged
  – Request PBGC approval
Unfavorable Projections

- Poor ways to respond to unfavorable projections: Punch your actuary
Unfavorable Projections

• Merged plan’s PPA funding projections have to be at least as favorable as pre-merger projections
  – Focus on future negative cash flow % (contributions less benefits and expenses as a % of assets) and funded ratios
  – Ideally, the merged plan’s projected negative cash flow % would decline or stay the same
  – Projected funded ratios would increase
Unfavorable Projections

- Pre-merger plan causing unfavorable projections can fix its problems before the merger or the merger agreement can require post-merger plan board to fix problems
  - Same old fix, reduce accruals and/or increase contributions
  - May be easier for new plan to fix problems (new board plus merger cost savings)
Fiduciary Considerations

• Who has the authority to merge?
  – Settlor function?
  – Review trust document
  – Do collective bargaining agreements or (other agreements) contradict trust agreement?

• Dispute resolution in event of deadlock
Fiduciary Considerations

• Fiduciary Responsibility
  – “Did you just call me the F-Word?!?”
  – Trustees must act solely in the interests of participants and beneficiaries in deciding on whether to merge
  – Must act prudently, consider all reasonable alternatives and consult with professionals
Fiduciary Considerations

• Are one plan’s participants paying for the other plan’s benefits or unfunded liability?
  – Importance of having the same future benefits
Fiduciary Considerations

• Prohibited transactions
  – Does merger benefit parties other than participants and beneficiaries?
     • Political considerations
  – Could be an issue if boards share trustees
     • Can be avoided if common trustees recuse themselves
  – Can appoint an independent fiduciary for merger
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The Nitty-Gritty of Pension Plan Mergers

• Mergers are not a panacea but can have significant benefits
• Importance of commonality between plans being merged
• Consider a fully funded plan design for future benefit accruals
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