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Setting a Withdrawal Liability Policy That Meets Your Strategic Objectives

In its 1995 Annual Report, the Pension Benefit Guaranty Corporation estimated that the total assets of all 2,000 multiemployer plans equaled 97% of total pension liabilities, and that all but a small number of plans were fully funded.

Since that time the situation has changed markedly – and for the worse. PBGC's 2004 Annual Report estimates that total underfunding in multiemployer plans was $150 billion, a 50% increase from the prior year and a *sevenfold* increase from the 1995 data.

The primary cause of the deterioration in multiemployer plan funding is stock market losses in recent years. For funds with negative cash flows typical of mature plans with large numbers of retirees over a shrinking contribution base of active workers, the problem is even more severe, as these funds are forced to draw on declining assets.

These negative developments have put "withdrawal liability" on the radar screens of plan trustees, contributing employers, and plan practitioners. Withdrawal liability is the financial obligation a contributing employer would face to shoulder its share of the financial burden of a multiemployer plan should it elect to withdraw from the plan. For many plans, withdrawal liability has not been a significant issue in the past because they had little or no unfunded liabilities. Some of these plans may not have formally adopted a method for allocating withdrawal liability, or maintained the records needed to calculate a participating employer's withdrawal liability.

Now with the emergence of large unfunded liabilities and a shrinking base of contributing employers, plan trustees need to ensure that there is a withdrawal liability determination method in place; that the method is appropriate given the funding status of the plan and the characteristics of contributing employers and the industries covered by the plan; they need to learn and understand the risk implications of the methods and approaches they adopt; and that the data needed to determine the amount of an employer's withdrawal liability is readily available.

Following are questions and answers regarding withdrawal liability plan trustees should consider:

Question 1: *Until recently our plan was fully funded, so we never had to assess withdrawal liability. As a result, we did not adopt a withdrawal liability allocation method. We now have unfunded liabilities, and some employers have recently withdrawn. Do we have to wait until we adopt an allocation method before we can assess these employers with withdrawal liability?*

Answer: You do not have to wait until a method is adopted. The withdrawal liability provisions of ERISA provide four methods that plans may use to determine an employer's withdrawal liability, as well as providing the use of other methods subject to approval of the PBGC. Except for plans in the construction industry, a plan may adopt any one of the four prescribed methods or an alternative method. One of the prescribed methods is the so-called "presumptive method," which is contained in section 4211(b) of ERISA. This method applies as the default, unless an eligible plan adopts another method, and it is the method that must be used by construction industry plans. The presumptive method has three components: 1) the plan's unfunded vested benefits as of the last plan year ending before September 26, 1980; 2) the change in the plan's unfunded vested benefits for each subsequent plan year; and 3) "reallocable" unfunded vested benefits.

Thus, in your case you would use the presumptive method to calculate the liability of employers who have withdrawn. This method continues to apply unless, assuming the plan is eligible, a different method is adopted.

Question 2: *I've reviewed the presumptive method, and it appears to require that we have data on unfunded vested benefits as far back as 1980, and employer contribution amounts from 1975. Our records don't go back that far, so what are we supposed to do?*

Answer: If the plan had no unfunded vested benefits in 1980, and thereafter until recently, then you need only to go back to the first year in which there were unfunded vested

benefits. If, for example, that year was 2000, you would treat that year as the last plan year ending before September 26, 1980, which is the first year in the presumptive method calculation, and then proceed in accordance with the method for each subsequent year.

Question 3: *Our plan did have unfunded vested benefits for several years during the 1980s, but was fully funded thereafter until 2003. In the years in which there were unfunded benefits, we did not calculate withdrawal liability, either because there were no withdrawals or we determined that the withdrawn employers had no assets. We would like to use the presumptive method, but we don't have records going back to the '80s. So what options do we have for withdrawals that occur in the future?*

Answer: If your plan is not a construction industry plan, you could deal with this problem by adopting a modification to the statutory presumptive method that would make the "initial" year 2004, instead of the last plan year ending before September 26, 1980, and the annual change years would be each subsequent plan year. This modification would have to be approved by the PBGC pursuant to section 4211(c)(5) of ERISA, and PBGC's Regulation 29 CFR 4211.

Question 4: *We've been using the presumptive method, and we'd like to continue to use it, but we don't think it is right to have to assess liability when the plan is fully funded. Is there any way we could avoid that result under the presumptive method?*

Answer: If your plan is not a construction plan, you could accomplish the desired result by adopting a modification to the presumptive method that would set to zero all allocable amounts for plan years preceding a plan year in which there were no unfunded vested benefits. Thus, if an employer withdrew in the plan year following a year in which there were no unfunded vested benefits, the amount of the withdrawal liability is zero. This modification would have to be approved by the PBGC.

Question 5: *What is the best method of assessing withdrawal liability?*

Answer: There is no one best solution for all plans. Rather, there are several factors to consider when adopting a withdrawal liability policy including the financial health of the industry, the maturity of the fund and the transfer of risk from the withdrawing employer to the continuing employers, your fiduciary obligations to the participants and beneficiaries of the plan, as well as what can be computed using available data.

We have seen instances where trustees have adopted stringent methods to discourage employers from withdrawing, and also plans where trustees have chosen to minimize withdrawal liability so that new employers are not discouraged from becoming participating employers.

However the primary consideration at this time should be in creating a policy that substantiates not only the appropriate method for allocating liability, but also the assumptions behind the calculations. Such a policy will embody who's at risk for unfunded liabilities, and how the balance is maintained between attracting new employers and the responsible assessment of obligations on withdrawing employers.

Cheiron's consultants can help you identify and weigh all the factors that will determine the most appropriate withdrawal liability policy. To learn more, contact Peter Hardcastle at phardcastle@cheiron.us or call 1-877-CHEIRON (243-4766).

Cheiron is a full-service actuarial consulting firm assisting corporations, public employers and Taft-Hartley plans manage their benefit plans proactively to achieve strategic objectives and safeguard the interests of plan participants and beneficiaries.