

**PRESENT LAW RELATING TO  
MULTIEMPLOYER DEFINED BENEFIT PLANS**

Scheduled for a Public Hearing  
Before the  
JOINT SELECT COMMITTEE ON THE SOLVENCY  
OF MULTIEMPLOYER PENSION PLANS  
on April 18, 2018

Prepared by the Staff  
of the  
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## INTRODUCTION AND SUMMARY

The Joint Select Committee on the Solvency of Multiemployer Pension Plans has scheduled a public hearing on April 18, 2018, on an overview of the multiemployer pension system. This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a discussion of present law relating to retirement plans generally and to multiemployer defined benefit plans in particular, as well as selected data relating to multiemployer defined benefit plans.

### **Present Law**

#### Qualified retirement plans

A plan of deferred compensation that meets the qualification requirements under the Internal Revenue Code of 1986 (“Code”)<sup>2</sup> (a “qualified retirement plan”) is accorded tax-favored treatment.

Tax-favored treatment for these vehicles generally consists of pretax treatment of contributions, tax-exempt status of the trust or account holding assets, and income inclusion by an individual only at the time of distribution, with the option of deferring income inclusion by rolling the distribution over to another tax-favored retirement vehicle. Any after-tax contributions, including Roth contributions, result in basis, which reduces the portion of a subsequent distribution that is included in income. Certain distributions from Roth arrangements are fully excluded from income. Tax-favored treatment includes a current deduction for contributions by a taxable employer.

Some requirements applicable to qualified retirement plans define participant rights and provide participant protections and generally have parallels under ERISA, which is within the jurisdiction of the Department of Labor (“DOL”). Some Code requirements limit tax benefits; some are aimed at providing retirement security for both lower-paid and higher-paid employees.

Enforcement of a qualified retirement plan requirement depends on the source of the requirement. Failure to meet a qualification requirement may mean the loss of tax-favored status; certain Code requirements are enforced through an excise tax. ERISA requirements are generally enforced by the DOL or participant suit.

Qualified retirement plans are of two general types: defined contribution plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses; and defined benefit plans, under which benefits are determined under a plan formula and paid from general plan assets, rather than individual

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Present Law Relating to Multiemployer Defined Benefit Plans* (JCX-30-18), April 17, 2018. This document can also be found on the Joint Committee on Taxation website at [www.jct.gov](http://www.jct.gov).

<sup>2</sup> Except as otherwise indicated, all section references herein are to the Code.

accounts. Some qualified retirement plans are referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan.

Qualified retirement plans are also categorized by the number of employers that maintain the plan and the type of employees covered by the plan. A single-employer plan is a plan maintained by one employer (treating members of controlled groups and affiliated service groups as one employer) and may cover collectively bargained employees (employees covered by a collective bargaining agreement), noncollectively bargained employees, or both. A multiple-employer plan is a single plan in which two or more unrelated employers (not members of the same controlled group or affiliated service group) participate. Multiemployer plans (also known as “Taft-Hartley” plans) are maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers; the collective bargaining agreements require the employers to contribute to the plan. Multiemployer plans are operated by a board of trustees (the “joint board” or “plan sponsor” for Code and ERISA purposes).

### Defined benefit plans

Benefits under a defined benefit plan are generally determined under a plan formula that generally takes into account compensation and service, referred to as a traditional defined benefit plan. However, hybrid defined benefit plans, such as cash balance plans, under which a participant’s benefit is expressed as a hypothetical account balance, are also common. The employer generally determines the benefit formula under a defined benefit plan, and benefits vary among plans. In the case of a multiemployer plan, the relevant collective bargaining agreements and the board of trustees determine the contributions and benefit formula.

Defined benefit plans are generally funded by employer contributions. Private defined benefit plans are subject to minimum funding requirements (and withdrawal liability rules in the case of multiemployer plans), and benefits under most private plans are guaranteed, within limits, by the Pension Benefit Guaranty Corporation (“PBGC”).

Defined benefit plans are generally subject to the same qualification requirements as defined contribution plans, though some requirements apply to the two types of plans differently. Defined benefit plans are also subject to some requirements that do not apply to defined contribution plans.

Defined benefit plans must provide benefits in the form of an annuity. In addition, a defined benefit plan generally cannot make in-service distributions before the earliest of normal retirement age, age 62, or plan termination.

Under the Code, annuity distributions from a defined benefit plan for a year generally cannot exceed the lesser of \$220,000 (for 2018) or the employee’s high-three-year average compensation. The dollar limit is generally reduced if distributions begin before age 62 and increased if distributions begin after age 65, and an actuarially adjusted limit applies to benefits paid in other forms, such as lump sums.

Spousal protections applicable to defined benefit plans generally require that benefits be paid in the form of a qualified joint and survivor annuity (“QJSA”) unless the participant elects a different form of distribution and the participant’s spouse consents to the election. A QJSA is

generally a life annuity for the participant with an annuity of at least 50 percent of the participant's annuity amount payable to the surviving spouse after the participant's death. Other forms of benefit offered to a married participant may not be actuarially more valuable than the QJSA. If a married participant dies before benefits begin, the plan must offer a survivor benefit for the spouse in the form of a qualified preretirement survivor annuity ("QPSA"), which is a survivor annuity for the spouse that is at least 50 percent of the employee's accrued benefit.

#### Defined contribution plans

Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pretax or after-tax contributions by employees, generally subject to a limit of the lesser of \$55,000 (for 2018) or the employee's compensation. Defined contribution plans may themselves be of different types (profit-sharing plans, stock bonus plans, or money purchase plans) and may include special features, such as a qualified cash or deferred arrangement (a section 401(k) plan) or an employee stock ownership plan ("ESOP"). A target benefit plan is a type of money purchase pension plan under which contributions are determined by reference to the amount necessary, on an actuarially determined basis, to fund a "target" annuity benefit determined under a formula contained in the plan.

#### Selected Qualification Requirements Applicable to Multiemployer Defined Benefit Plans

##### Definitely determinable requirement

The formula under a defined benefit plan must provide benefits that are definitely determinable; that is, the plan must contain an express formula for determining benefits that is not subject to the discretion of the employer (or joint board in the case of a multiemployer plan). Any actuarial assumptions relevant in determining benefits must be specified in the plan.

##### Vesting, accrual, and anti-cutback rules

In the case of a defined benefit plan, a participant's accrued benefit is the portion of the normal retirement benefit (that is, the annuity payable at normal retirement age under the plan's benefit formula) that has accrued under the accrual method provided under the plan. A participant must be vested at all times in the portion of the accrued benefit under a defined benefit plan attributable to his or her own contributions, if any. With respect to the employer-provided portion of the accrued benefit under a defined benefit plan using a traditional benefit formula, minimum vesting must occur under one of two vesting schedules: 100 percent vesting after five years of service, or 20 percent, 40 percent, 60 percent, 80 percent, and 100 percent, respectively, over the period of three to seven years of service. Under a hybrid plan, full vesting must occur after three years of service. Full vesting must also occur at normal retirement age and, generally, on plan termination.

Under the accrual (or anti-backloading) rules, benefits must accrue in one of three permissible patterns over a participant's period of service in order to prevent significant accruals to be delayed until later years of service. Reductions in an employee's rate of accrual due to increasing age generally are prohibited.

Various forms of benefits under a defined benefit plan (referred to as optional forms of benefit) must generally be actuarially equivalent to the normal retirement benefit or may be provided on an actuarially subsidized basis. Lump-sum benefits must be no less than the amount determined using certain specified interest and mortality assumptions.

Under the anti-cutback rules, a plan amendment generally may not reduce accrued benefits or reduce or eliminate an optional form of benefit, early retirement benefit or retirement-type subsidy with respect to accrued benefits. Amendments are generally permitted only to reduce future rates of accrual, eliminate optional forms of benefits, or eliminate or reduce early retirement benefits or retirement-type subsidies only with respect to future accruals; and, in those cases, notice must be provided.

#### Anti-cutback exceptions for multiemployer plans

In the case of a multiemployer defined benefit plan that is in critical status<sup>3</sup> or critical and declining status,<sup>4</sup> or is insolvent,<sup>5</sup> subject to notice and other procedural requirements, certain plan benefits that would otherwise be protected under the anti-cutback rules are required or permitted to be reduced or eliminated.

In the case of a multiemployer plan in critical status, payments in excess of a single life annuity (plus any social security supplement, if applicable) may not be made to a participant or beneficiary who begins receiving benefits after notice that the plan is in critical status is provided. In addition, the plan sponsor may reduce certain benefits (“adjustable benefits”) that the plan sponsor deems appropriate, but not for a participant or beneficiary who began to receive benefits before receiving notice that the plan is in critical status. Adjustable benefits generally include disability benefits not in pay status, early retirement benefits or retirement-type subsidies, and most benefit payment options, but not the amount of an accrued benefit payable at normal retirement age.

In general, a multiemployer plan is insolvent when its available resources in a plan year are not sufficient to pay the plan benefits for that plan year. In that case, benefits must be reduced to the level that can be covered by the plan’s assets, but not below the level of benefits that are eligible for guarantee under the PBGC’s multiemployer plan program. If plan assets are insufficient to pay benefits at the guarantee level, the PBGC provides financial assistance to the plan in the form of loans.

A multiemployer plan is in critical and declining status if the plan (1) is in critical status and (2) is projected to become insolvent during the current plan year or any of the 14 succeeding plan years (19 succeeding plan years if either the ratio of inactive plan participants to active plan participants is more than two to one or the plan’s funded percentage is less than 80 percent). In that case, subject to certain conditions, limitations, and procedural requirements, including the

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<sup>3</sup> See Part I.D.3 for the definition of critical status.

<sup>4</sup> See Part I.C.3 for the definition of critical and declining status.

<sup>5</sup> See Part I.C.2 for the definition of insolvent status.

appointment of a retiree representative in some cases and approval by the Secretary of Treasury, previously earned benefits may be reduced (referred to as benefit suspensions), including benefits of some participants and beneficiaries in pay status.

Benefit suspensions are permitted only if the plan actuary certifies that, taking the benefit suspensions into account, the plan is projected to avoid insolvency, and the plan sponsor determines that, despite all reasonable measures to avoid insolvency, the plan is projected to become insolvent unless benefits are suspended.

The plan sponsor generally determines the amount of the benefit suspensions and how the suspensions apply to plan participants and beneficiaries. However, benefits cannot be reduced below 110 percent of the monthly PBGC guarantee level; disability benefits cannot be suspended; benefit reductions for a participant or beneficiary between the ages of 75 and 80 are limited; benefit reductions are not permitted for a participant or beneficiary age 80 or over; and benefit suspensions in the aggregate must be at the level reasonably estimated to achieve, but not materially exceed, the level that is necessary to avoid insolvency.

### Funding and Deduction Rules for Multiemployer Defined Benefit Plans

#### In general

Employer contributions to a defined benefit plan are generally subject to minimum funding requirements, the details of which depend on whether the plan is a single-employer plan or a multiemployer plan. Unless a funding waiver is obtained, an employer may be subject to a two-tier excise tax if the funding requirements are not met.

In general, the annual deduction limit on employer contributions to a multiemployer defined benefit plan for a year is the excess of (1) 140 percent of the plan's current liability (the present value of all benefits earned under the plan), over (2) the value of plan assets. However, the deduction limit is never less than the amount of contributions required under the funding rules. If contributions exceed the amount deductible, the employers that contribute to the multiemployer plan are generally subject to an excise tax.

#### General funding rules for multiemployer plans

General funding requirements apply to all multiemployer plans. Additional funding requirements apply to plans in endangered<sup>6</sup> or critical status. An employer that withdraws from a multiemployer plan is generally liable to the plan for a portion of the plan's unfunded vested benefits, referred to as withdrawal liability. Various provisions limit the amount of an employer's withdrawal liability.

Under the general funding requirements, a multiemployer defined benefit plan maintains a funding standard account, to which charges (such as for benefit accruals and negative plan experience) and credits (such as for positive plan experience and contributions) are made. The minimum required contribution for a plan year is the amount, if any, needed to balance

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<sup>6</sup> See Part I.D.3 for the definition of endangered status.

accumulated credits and accumulated charges to the funding standard account. If required contributions are not made, so the funding standard account has a negative balance, an accumulated funding deficiency results.

A multiemployer plan is required to use an acceptable actuarial cost method (referred to as the plan's funding method) to determine the elements included in its funding standard account for a year, including normal cost and supplemental cost. Normal cost generally represents the cost of future benefits allocated to the year under the plan's funding method. The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. Supplemental costs may be attributable to past service liability or to worse than expected plan experience. Supplemental costs are amortized (that is, recognized for funding purposes) over a specified number of years (generally 15 years) by annual charges to the funding standard account over that period. Factors that result in a supplemental loss can alternatively result in a gain that is recognized by annual credits to the funding standard account over a 15-year amortization period (in addition to a credit for contributions made for the plan year).

Actuarial assumptions used under the multiemployer plan funding rules must be reasonable. The interest rate (which represents the expected return on plan assets over time) and mortality assumptions used in funding computations are subject to these general standards; the funding rules do not specify the interest rate or mortality tables that must be used. For funding purposes, the actuarial value of plan assets may be used, rather than fair market value, subject to certain conditions.

#### Additional requirements for multiemployer plans in endangered or critical status

Additional funding rules apply to a multiemployer defined benefit pension plan that is in endangered or critical status, which is determined by reference to several funding-related factors, such as the plan's funded percentage (generally the ratio of the actuarial value of plan liabilities over the value of plan assets). These rules require the adoption of and compliance with: (1) a funding improvement plan in the case of a multiemployer plan in endangered status; and (2) a rehabilitation plan in the case of a multiemployer plan in critical status. In the case of a plan in critical status, additional required contributions apply, certain benefit reductions are permitted, and employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules, provided that a rehabilitation plan is adopted and followed.

#### Multiemployer Plan Program of the Pension Benefit Guaranty Corporation

The PBGC, a corporation within DOL, provides an insurance program for benefits under most defined benefit plans maintained by private employers. The PBGC is administered by a director. Its board of directors consists of the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Commerce.

The PBGC is financed through the payment of premiums by covered defined benefit plans, assets from terminated single-employer defined benefit plans trustee by the PBGC, and investment income on PBGC assets. The PBGC insures pension benefits under separate programs for single-employer and multiemployer defined benefit plans.

In the case of a multiemployer plan, flat-rate premiums apply at a rate of \$28 per participant for 2018. The PBGC provides financial assistance to insolvent multiemployer plans in the amount needed to pay benefits at the guarantee limit, which is the sum of 100 percent of the first \$11 of monthly benefits plus 75 percent of the next \$33 of monthly benefits multiplied by the participant's years of service.

In order to avoid plan insolvency, the PBGC may provide support and financial assistance in connection with a merger of multiemployer plans, or may order the partition of a multiemployer plan and provide financial assistance to the new plan created by the partition, subject to various conditions, including a determination that the PBGC's ability to meet financial assistance obligations to other plans will not be impaired and the provision of notice to the House Committees on Education and the Workforce and on Ways and Means and the Senate Committees on Finance and on Health, Education, Labor, and Pensions.

#### Data on Funding of Multiemployer Plans and Status of PBGC Multiemployer Program

As of 2016, 1,375 defined benefit plans were insured under the PBGC multiemployer program with a total of about 10.5 million participants. The aggregate funded status of multiemployer plans as of 2014 was 49 percent, with total plan assets of about \$468 billion and liabilities of about \$963 billion. Among underfunded multiemployer plans, the 50 plans with the highest levels of underfunding accounted for about 54 percent of the total underfunding (about \$307 billion in underfunding).

As of September 30, 2017, PBGC's multiemployer plan insurance program had total assets of about \$2.3 billion and total liabilities of about \$67 billion (including the present value of future nonrecoverable financial assistance provided to multiemployer plans), for a net negative position of about \$65 billion, reflecting sharp increases in liabilities in recent years.

## PRESENT LAW

### A. Qualified Retirement Plans<sup>7</sup>

#### 1. In general

A qualified retirement plan is a plan of deferred compensation that meets the qualification requirements under the Code and, as a result, is accorded tax-favored treatment.<sup>8</sup> Tax-favored treatment generally consists of pretax treatment of employer and some employee contributions,<sup>9</sup> tax-exempt status of the trust or account holding assets, and income inclusion by a participant or beneficiary only at the time of benefit distributions from the plan, with the option of deferring income inclusion by rolling the distribution over to another tax-favored retirement vehicle.<sup>10</sup> To the extent employee contributions are made on an after-tax basis, the contributions result in basis, which reduces the amount included in income at the time of distribution. In the case of Roth contributions made to an employer-sponsored plan, contributions are always made on an after-tax basis, and certain distributions are fully excluded from income.<sup>11</sup> In addition, in the case of a taxable employer, the employer is entitled to a current deduction (within limits) for contributions even though the contributions are not currently included in an employee's income.

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<sup>7</sup> For a more detailed discussion of tax-favored retirement savings generally, including individual retirement arrangements ("IRAs"), see Joint Committee on Taxation, *Present Law and Background Relating to Tax-Favored Retirement Saving and Certain Related Legislative Proposals* (JCX-3-16), January 26, 2016, available at [www.jct.gov](http://www.jct.gov).

<sup>8</sup> Qualification requirements under section 401(a) apply to qualified retirement plans. A qualified annuity plan under section 403(a) is similar to a qualified retirement plan (and subject to similar requirements) except that plan assets consist of annuity contracts, rather than investments held in a trust or custodial account. References herein to a qualified retirement plan include a qualified annuity plan. Additional options for tax-favored retirement plans are available to certain tax-exempt or State or local government employers: tax-deferred annuities under section 403(b) for organizations exempt from tax under section 501(c)(3) and public schools (called section 403(b) plans) and State and local government eligible deferred compensation plans under section 457(b) (called governmental section 457(b) plans). Certain small employers have the option of maintaining a SIMPLE IRA plan under section 408(p), or an employer may maintain simplified employee pension ("SEP") under section 408(k), either of which is funded through direct contributions by the employer to an IRA established for each employee.

<sup>9</sup> Employer contributions to tax-favored retirement plans are also exempt from Social Security and Medicare taxes applicable to wages under the Federal Insurance Contributions Act ("FICA"), sections 3101-3128; the Railroad Retirement Tax Act ("RRTA"), sections 3201-3241; and the Federal Unemployment Tax Act ("FUTA"), sections 3301-3311.

<sup>10</sup> Subject to some exceptions, a distribution from a tax-favored retirement savings arrangement before age 59½ that is includible in income is also subject to an additional 10-percent early withdrawal tax. Under the minimum distribution requirements, distributions from a tax-favored retirement savings arrangement (other than a Roth IRA) are generally required to begin within a certain period after attainment of age 70½ and must be taken over the individual's life or life expectancy. Minimum distribution requirements also apply after a participant's death (including to Roth IRAs). An excise tax may apply if required minimum distributions are not made.

<sup>11</sup> Sec. 402A.

Present law imposes a number of requirements on qualified retirement plans that must be satisfied for favorable tax treatment to apply.<sup>12</sup> Some of these requirements define the rights of plan participants and beneficiaries, such as the minimum participation and vesting requirements.

Under the minimum participation rules, a plan generally cannot delay an employee's participation in the plan beyond the later of completion of one year of service (that is, a 12-month period with at least 1,000 hours of service) or attainment of age 21.<sup>13</sup> In addition, a plan cannot exclude an employee from participation on the basis of attainment of a specified age. Employees can be excluded from plan participation on other bases, such as job classification, as long as the other basis is not an indirect age or service requirement.

Under the vesting rules, a participant's right to the benefits he or she has accrued under a plan ("accrued benefit") generally must become nonforfeitable after a specified period of service and at attainment of normal retirement age under the plan.<sup>14</sup> Benefits attributable to employee contributions must be fully vested at all times. The period of service after which benefits attributable to employer contributions must be vested depends on the type of plan (defined benefit or defined contribution), as discussed below.

The amount of an employee's compensation taken into account in determining plan contributions and benefits cannot exceed an annual limit (\$275,000 for 2018). A qualified retirement plan is prohibited from discriminating in favor of highly compensated employees, referred to as the nondiscrimination requirements. These requirements are intended to ensure that a qualified retirement plan provides meaningful benefits to an employer's rank-and-file employees as well as highly compensated employees, so that qualified retirement plans achieve the goal of retirement security for both lower-paid and higher-paid employees. The nondiscrimination requirements consist of a minimum coverage requirement and general nondiscrimination requirements.<sup>15</sup> For purposes of these requirements, an employee generally is treated as highly compensated if the employee (1) was a five-percent owner of the employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in

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<sup>12</sup> In general, for purposes of these requirements, members of controlled groups under section 414(b) or (c) and affiliated service groups under section 414(m) or (o) are treated as a single employer.

<sup>13</sup> Sec. 410(a).

<sup>14</sup> Sec. 411.

<sup>15</sup> Sections 401(a)(3) and 410(b) deal with the minimum coverage requirement; section 401(a)(4) deals with the general nondiscrimination requirements, with related rules in section 401(a)(5). Detailed regulations implement the statutory requirements. In addition to the minimum coverage and general nondiscrimination requirements, the group employees who accrue benefits under a defined benefit plan for a year must consist of at least 50 employees, or, if less, 40 percent of the workforce, subject to a minimum of two employees accruing benefits. Governmental plans are not subject to these requirements.

excess of \$120,000 (for 2018).<sup>16</sup> A plan covering collectively bargained employees, including a multiemployer plan, is generally deemed to satisfy the nondiscrimination requirements.

Assets of a qualified retirement plan must be held in a trust or custodial account for the exclusive benefit of plan participants, and prohibited transaction rules (that is, rules prohibiting self-dealing by employers and plan fiduciaries) apply to plan assets.<sup>17</sup> Defined benefit plans and some defined contribution plans are subject to minimum funding requirements.

Qualified retirement plans of private employers are generally also subject to regulation under Title I of the Employee Retirement Income Security Act of 1974 (“ERISA”), which is under the jurisdiction of the DOL. The ERISA rules generally relate to the rights of plan participants and beneficiaries, reporting and disclosure, and the obligations of plan fiduciaries. Some of the provisions of the Code and ERISA that apply to qualified retirement plans are identical or very similar.<sup>18</sup> For example, ERISA includes minimum participation and vesting requirements that parallel those under the Code.<sup>19</sup>

### **Enforcement of qualified retirement plan requirements**

Enforcement of a qualified retirement plan requirement depends on the source of the requirement. The qualification requirements under the Code are enforced by the IRS. If a plan fails to meet the qualification requirements, then the favorable tax treatment for such plan may be denied; that is, the employer may lose tax deductions and employees may have current income taxation. As a practical matter, the IRS rarely disqualifies a plan. Instead, the IRS may impose sanctions short of disqualification and require the employer to correct any violation of the qualification rules.

Certain Code requirements for qualified plans are enforced through an excise tax rather than through disqualification. For example, a failure to satisfy the minimum funding requirements for defined benefit plans, discussed below, does not result in disqualification of the plan. Instead, in general, an excise tax is imposed on the employer, subject to exceptions in the case of certain multiemployer plans. Employees do not have a right to sue to enforce the qualified retirement plan requirements under the Code.

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<sup>16</sup> Sec. 414(q). At the election of the employer, employees who are highly compensated based on compensation may be limited to the top 20 percent highest paid employees. A nonhighly compensated employee is an employee other than a highly compensated employee.

<sup>17</sup> Secs. 401(a)(2) and 4975. Under this exclusive benefit requirement, prior to satisfaction of all liabilities under the plan with respect to employees and their beneficiaries, assets are not allowed to be used for or diverted to purposes other than the exclusive benefit of employees or their beneficiaries.

<sup>18</sup> Governmental plans and church plans are generally exempt from ERISA and from the Code requirements that correspond to ERISA requirements.

<sup>19</sup> ERISA secs. 202 and 203.

ERISA's requirements generally may be enforced through administrative actions by DOL or by lawsuits brought by plan participants, DOL, or plan fiduciaries.

## **2. Types of qualified retirement plans**

### **Defined benefit and defined contribution plans**

Qualified retirement plans are broadly classified into two categories, defined contribution plans and defined benefit plans, based on the nature of the benefits provided.<sup>20</sup> Although both types of plans are subject to the qualification requirements, the requirements differ somewhat for the two types of plans.

Under a defined contribution plan, a separate account is maintained for each participant, to which contributions are allocated and investment earnings (and losses) are credited, and a participant's benefits are based solely on the participant's account balance.<sup>21</sup> Defined contribution plans commonly allow participants to direct the investment of their accounts. Because the account balance, and thus the participant's benefits, depends on the rate of return on the account, the risk of investment loss (and reward of investment gain) under a defined contribution plan lies with the participant rather than the employer.

Under a defined benefit plan, benefits are determined under a plan formula.<sup>22</sup> Benefits under a defined benefit plan are funded by the general assets of the trust established under the plan, which are invested by plan fiduciaries in accordance with plan terms; individual accounts are not maintained for employees participating in the plan. Defined benefit plans maintained by one or more private employers are generally subject to minimum funding requirements intended to ensure that plan assets are sufficient to pay the benefits under the plan. Benefits under private defined benefit plans are generally guaranteed (within limits) by the PBGC under Title IV of ERISA.

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<sup>20</sup> Under the Code as in effect since before ERISA, retirement plans fall into three general types - pension plans, profit-sharing plans, and stock bonus plans, defined respectively at Treas. Reg. sec. 1.401-1(b)(1)(i), (ii), and (iii). Defined benefit plans and money purchase pension plans (a type of defined contribution plan, discussed below) are pension plans under the Code; other defined contribution plans are either profit-sharing plans or stock bonus plans (discussed below). The application of some Code and ERISA requirements depends on whether the plan is a pension plan, a profit-sharing plan, or a stock bonus plan. Under ERISA, the term "pension plan," defined at ERISA section 3(2)(A), includes both defined benefit plans and defined contribution plans.

<sup>21</sup> Defined contribution plan is defined at Code section 414(i) and ERISA section 3(34). Under ERISA, defined contribution plans are also referred to as individual account plans.

<sup>22</sup> As defined in Code section 414(j) and ERISA section 3(35), a defined benefit plan is any plan that is not a defined contribution plan. As discussed further below, the Code requires benefits under a defined benefit plan to be determined under a formula specified in the plan.

Certain types of qualified retirement plans are referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan. However, legally, the plan is either a defined contribution plan or a defined benefit plan.<sup>23</sup>

### **Single-employer, multiple-employer, and multiemployer plans**

Qualified retirement plans are categorized for some purposes as one of three types, based on the number of employers that maintain the plan and the type of employees covered by the plan. The three types are single-employer plans, multiple-employer plans, and multiemployer plans.

A single-employer plan is a plan maintained by one employer. For this purpose, businesses and organizations that are members of a controlled group, a group under common control, or an affiliated service group are treated as one employer (referred to as “aggregation”). A single-employer plan may cover employees who are also covered by a collective bargaining agreement (“collectively bargained employees”), pursuant to which the plan is maintained (a “collectively bargained plan”). An employer may maintain separate single-employer plans for collectively and noncollectively bargained employees, or cover both types of employees under the same plan.

A multiple-employer plan is a single plan maintained by two or more unrelated employers (that is, employers that are not treated as a single employer under the aggregation rules) and that is not a multiemployer plan (as defined below).<sup>24</sup> Multiple-employer plans are commonly maintained by employers in the same industry. A multiple-employer plan may cover collectively bargained employees or noncollectively bargained employees.

A multiemployer plan (also known as a “Taft-Hartley” plan, and distinct from a multiple-employer plan) is a plan maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s).<sup>25</sup> Multiemployer plans commonly cover collectively bargained employees in a particular industry. A multiemployer plan is not operated by the contributing employers; instead, it is governed by a board of trustees (“joint board”) consisting of labor and employer representatives. In applying Code and ERISA requirements, the joint board has a status similar to an employer maintaining a single-employer plan and is referred to as the “plan sponsor.”

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<sup>23</sup> Under section 414(k) and ERISA section 3(35), a defined benefit plan that provides a benefit based partly on the balance of a separate account for a participant is treated as a defined contribution plan for certain purposes.

<sup>24</sup> Sec. 413(c) and ERISA sec. 210(a).

<sup>25</sup> Sec. 414(f) and ERISA sec. 2(37). The terms of the relevant collective bargaining agreements specify the amounts employers are required to contribute to a multiemployer plan.

### **3. Defined benefit plans**

#### **In general**

As discussed above, benefits under defined benefit plan are based on a plan formula, rather than based on assets in an actual account balance maintained for a participant or actual plan assets. Traditionally, a defined benefit plan formula has provided benefits expressed as a life annuity commencing at normal retirement age, based on a formula that takes into account an employee's compensation and years of service or provides a dollar amount of benefit per year of service (often referred to as a traditional defined benefit plan formula or a traditional defined benefit plan). However, under some defined benefit plans, such as cash balance plans, benefits are determined by reference to hypothetical account balances that resemble accounts maintained for participants under a defined contribution plan. These plans are commonly referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan. However, legally, they are defined benefit plans.<sup>26</sup>

Subject to the applicable qualification rules, the employer (and, in the case of collectively bargained plans, employee representatives) generally determines the benefit formula under a defined benefit plan, as well as other plan features. Thus, benefits under such plans vary from employer to employer, and, in some cases, from plan to plan of the same employer. In the case of a multiemployer plan, the plan may include more than one benefit formula, with the benefit formula applicable to a group of employees determined by the employer contribution rate under the collective bargaining agreement covering the group.

Benefits under a defined benefit plan are funded by the general assets of the trust established under the plan, which are invested by plan fiduciaries. Defined benefit plans are generally funded by employer contributions, in an amount determined on an actuarial basis to be needed over time to provide the benefits under the plan, and, as discussed below, employers are generally subject to minimum funding requirements with respect to defined benefit plans.

The common view has been that, because benefits under a defined benefit plan are funded by trust assets generally and the funding rules require employer contributions to fund the promised benefits, investment risk under a defined benefit plan is born by the employer. However, participants in an underfunded defined benefit plan also bear the risk of losing benefits in the case of a distress termination of a single-employer defined benefit plan or, in the case of a multiemployer defined benefit plan, as a result of benefit reductions under a plan in critical or critical and declining status or as a result of plan insolvency, as discussed below. In addition, as discussed below, the PBGC bears some of the risk associated with underfunded defined benefit plans.

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<sup>26</sup> Under section 411(a)(13)(C) and ERISA 203(f)(3), these plans are called "applicable defined benefit plans."

## **Qualification requirements**

### **In general**

The specifics of some qualification requirements vary between defined benefit plans and defined contribution plans. In some cases, such as the vesting requirements, some aspects apply only to defined benefit plans. In addition, some qualification requirements apply only to defined benefit plans. For example, under a defined benefit plan, forfeitures cannot be used to increase benefits.<sup>27</sup>

Defined benefit plans are subject to certain additional distribution requirements under the Code, including a requirement that the plan provide benefits in the form of an annuity after retirement.<sup>28</sup> These requirements apply to all qualified defined benefit plans, including governmental plans and church plans. Defined benefit plans may not provide for distributions to a participant during employment (referred to as in-service distributions) unless the participant has attained normal retirement age (or age 62, if earlier) or in the case of plan termination.<sup>29</sup>

### **Benefit limits applicable to defined benefit plans**

A participant's annual benefit under a defined benefit plan generally must be limited to the lesser of a dollar amount (\$220,000 for 2018) and the participant's average compensation for the three years resulting in the highest average.<sup>30</sup> The compensation limit does not apply to benefits under certain plans, including a multiemployer plan. The benefit limit applies to the aggregate of all benefits accrued by an employee under all defined benefit plans maintained by the same employer, other than multiemployer plans.<sup>31</sup> In general, the dollar limit is prorated in the case of a participant with fewer than 10 years of participation in a plan, and the compensation limit is prorated in the case of a participant with fewer than 10 years of service with the employer.

The dollar limit applies to benefits commencing between age 62 and age 65 in the form of a straight life annuity for the life of the employee. For this purpose, a straight life annuity is an annuity payable in equal installments for the life of the participant that terminates upon the participant's death. If benefits under a plan are paid in a form other than a straight life annuity commencing between age 62 and age 65, the benefits payable under the other form (including any benefit subsidies) generally cannot exceed the dollar limit when actuarially converted to a

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<sup>27</sup> Sec. 401(a)(8).

<sup>28</sup> Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b)(1)(i). The plan may also provide benefits in other distribution forms.

<sup>29</sup> Sec. 401(a)(36); Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b)(1)(i).

<sup>30</sup> Sec. 415(b).

<sup>31</sup> For purposes of aggregating plans, members of a controlled group or affiliated service group are treated as a single employer, except a 50-percent ownership test is used.

straight life annuity commencing at age 62.<sup>32</sup> Thus, the dollar limit is effectively reduced for distributions commencing before age 62, or for a form of benefit more valuable than a straight life annuity, and increased for distributions commencing after age 65. However, if benefits are paid in the form of a QJSA (discussed below), no actuarial reduction is required to reflect the value of the survivor benefit, even if the surviving spouse annuity is 100 percent of the participant's benefit.

### QJSA and QPSA requirements

Defined benefit plans must comply with requirements that provide certain annuity benefits to the participant and to the spouse of a married participant.<sup>33</sup> In particular, defined benefit plans must provide that, whenever a distribution is permitted under the plan, the default form of benefit under the plan is a QJSA. For an unmarried employee, a QJSA is a life annuity; for a married employee, a QJSA generally is a life annuity for the employee with a survivor annuity of at least 50 percent (and not more than 100 percent) for the employee's spouse.<sup>34</sup> The benefit must be paid in the form of a QJSA unless, after receiving a notice explaining the relative value of the QJSA to other forms of distribution, the employee elects another form of distribution and, if the employee is married, the employee's spouse provides notarized consent to the alternative form of distribution elected, as well as to any other beneficiary designated by the employee with respect to the form of distribution elected by the employee.

If a married employee dies before beginning the payment of benefits, the plan must offer a survivor benefit for the spouse in the form of a QPSA, which is a survivor annuity for the spouse that is at least 50 percent of the employee's accrued benefit. Notarized spousal consent by the employee's spouse is required also for the employee to waive the QPSA or elect a different beneficiary or a different form of survivor benefit.

In the case of a defined benefit plan, the other forms of benefit offered to a married participant under the plan are not permitted to be actuarially more valuable than the QJSA payable at the time of the distribution. Finally, the QJSA and QPSA requirements only apply if the actuarial present value of the employee's accrued benefit at the time of the distribution (calculated using the same actuarial assumptions that apply in determining minimum lump-sum benefits) is more than \$5,000.<sup>35</sup>

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<sup>32</sup> Specified interest and, in some cases, mortality assumptions apply in making these adjustments.

<sup>33</sup> Secs. 401(a)(11) and 417 and ERISA sec. 205.

<sup>34</sup> The plan generally must provide a second joint and survivor annuity option for married participants, a qualified optional survivor annuity ("QOSA") with a survivor annuity rate (as a percentage of the annuity during the participant's lifetime) of 50 percent or 75 percent, depending on the survivor annuity rate under the plan's QJSA.

<sup>35</sup> The portion of an accrued benefit attributable to amounts that were rolled over to the plan may be disregarded in determining whether present value exceeds \$5,000.

#### 4. Defined contribution plans

Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pretax or after-tax contributions by employees. Total contributions made to an employee's account for a year cannot exceed the lesser of \$55,000 (for 2018) or the employee's compensation. A participant must at all times be fully vested in his or her own contributions to a defined contribution plan and must vest in employer contributions under three-year cliff vesting or two-to-six-year graduated vesting.

Defined contribution plans may themselves be of different types, specifically, profit-sharing plans, stock bonus plans, or money purchase plans, and may include special features, such as a qualified cash or deferred arrangement (a section 401(k) plan) or an employee stock ownership plan ("ESOP").

Profit-sharing plans were originally intended as a means of enabling employees to share in the profits of the employer's business. However, under present law, contributions to a profit-sharing plan are permitted regardless of whether the business has profits. A profit-sharing plan may provide for regular employer contributions each year or may provide that contributions are made each year at the discretion of the employer (called a "discretionary" profit-sharing plan). A profit-sharing plan must provide a definite formula under which contributions are allocated to participant accounts and must specify the events upon which distributions will be made to participants, such as severance from employment.

A stock bonus plan is similar to a profit-sharing plan except that benefits are distributable in stock of the employer. The plan may provide for cash distributions, but must also allow participants to take distributions in the form of employer stock. In the case of employer stock that is not publicly traded, participants generally must be given the right to require the employer to repurchase the stock under a fair valuation formula.

An ESOP is a stock bonus plan that is designated as an ESOP and is designed to invest primarily in employer stock.<sup>36</sup> An ESOP can be an entire plan or it can be a portion of a defined contribution plan. ESOPs are subject to additional requirements that do not apply to other plans that hold employer stock. In addition, certain benefits are available to ESOPs that are not available to other types of qualified retirement plans, including an exception to the prohibited transaction rules for certain loans and, in the case of a C corporation, higher deduction limits.

A profit-sharing plan or a stock bonus plan may be a section 401(k) plan, under which an employee may elect to have contributions (elective deferrals) made to the plan, rather than receive the same amount in cash.<sup>37</sup> For 2018, elective deferrals of up to \$18,500 may be made, plus up to \$6,000 in catch-up contributions for employees aged 50 or older, or, if less, the employee's compensation. Elective deferrals are generally made on a pretax basis. However, a section 401(k) plan may include a qualified Roth contribution program under which elective

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<sup>36</sup> Sec. 4975(e)(7).

<sup>37</sup> Sec. 401(k).

deferrals are made on an after-tax basis (designated Roth contributions), and certain distributions (“qualified distributions”) are excluded from income.<sup>38</sup> Many section 401(k) plans provide for matching contributions and may also provide for employer nonelective contributions and after-tax employee contributions.

A money purchase pension plan must provide for a set level of required employer contributions (that is, employer contributions may not be discretionary), generally as a specified percentage of participants’ compensation. A money purchase pension plan is subject to the minimum funding requirements, and the employer is generally subject to an excise tax if it fails to make the contributions required under the plan. Similar to defined benefit plans, a money purchase pension plan must offer benefits payable in the form of an annuity and may not provide for in-service distributions except at normal retirement age (or age 62, if earlier) or in the case of plan termination. Money purchase pension plans are subject to the QJSA and QPSA requirements described above.<sup>39</sup>

A target benefit plan is a money purchase pension plan under which contributions to an employee’s account are determined by reference to the amount necessary, on an actuarially determined basis, to fund a “target” benefit for the employee in the amount of an annuity commencing at normal retirement age determined under a formula contained in the plan. However, as in the case of defined contribution plans generally, an employee’s benefit under a target benefit plan is based on the employee’s account balance, which, depending on investment experience, may be more or less than the target benefit.

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<sup>38</sup> Sec. 402A.

<sup>39</sup> Profit-sharing plans and stock bonus plans are generally not subject to the QJSA and QPSA requirements unless the participant elects an annuity form of distribution. However, a profit-sharing or stock bonus plan must provide that a participant’s entire vested account balance under the plan will be paid to the participant’s surviving spouse unless the spouse consents in writing to a different beneficiary.

## **B. Selected Requirements for Benefits Under a Defined Benefit Plan**

### **1. Definitely determinable benefit formula**

As noted above, a defined benefit plan is required to provide benefits in the form of an annuity and may offer other forms of distributions as options. The benefit formula under a defined benefit plan must provide benefits that are definitely determinable (referred to as the “definitely determinable requirement”).<sup>40</sup> In order to meet the definitely determinable requirement, the plan must contain an express formula under which participants’ benefits can be computed and that is not subject to the discretion of the employer or, in the case of a multiemployer plan, the plan sponsor.<sup>41</sup> A formula may include a variable factor that provides for self-adjusting changes that are independent of employer or plan sponsor discretion.<sup>42</sup>

In order to satisfy the definitely determinable requirement, if the amount of a benefit under a defined benefit plan is determined on the basis of actuarial assumptions, the assumptions must be specified in the plan in a way that precludes employer or plan sponsor discretion.<sup>43</sup> For example, a plan may specify that a variable interest rate will be used in determining actuarial equivalent forms of benefit, but may not give the employer discretion to choose the interest rate.

IRS guidance considers a plan under which benefits payable to participants are determined on the basis of a number of shares or units of interest in the total assets of the plan (from which benefits are to be paid), with the dollar amount of the benefit payable varying from time to time to the extent of variation in the market value of plan assets (determined as of the date of a benefit payment or as of a specified date preceding the date of payment by no more than a year).<sup>44</sup> As described in the guidance, the number of shares or units on which a benefit is based is definitely determinable under the plan. The guidance holds that the plan provides for definitely determinable benefits.<sup>45</sup>

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<sup>40</sup> Treas. Reg. sec. 1.401-1(b)(1)(i). Under the regulations and section 401(a)(8), funds resulting from benefit forfeitures may not be used to increase benefits under the plan.

<sup>41</sup> Rev. Rul. 79-90, 1979-1 C.B. 155; Rev. Rul. 74-385, 1974-2 C.B. 130.

<sup>42</sup> Rev. Rul. 79-90.

<sup>43</sup> Sec. 401(a)(25); Rev. Rul. 79-90.

<sup>44</sup> Rev. Rul. 185, 1953-2 C.B. 202.

<sup>45</sup> The guidance deals with the application of the definitely determinable requirement under Treas. Reg. sec. 29.165-1(a), the predecessor to Treas. Reg. sec. 1.401-1(b)(1)(i). The guidance also holds that a plan provides for definitely determinable benefits when, under the plan, benefits that are otherwise definitely determinable in amount are subject to increase or decrease in amount at the time of payment to the extent (but only to the extent) of the fluctuation of a specified and generally recognized cost-of-living index.

## 2. Vesting, accrual, and anti-cutback rules

### Vesting

The vesting and related requirements applicable under the Code and ERISA generally provide protection for the participant's accrued benefit and optional forms of benefit, including subsidized optional forms of benefit under a defined benefit plan.<sup>46</sup> In the case of a defined benefit plan, a participant's accrued benefit is generally the portion of the normal retirement benefit (that is, the annuity payable at normal retirement age under the plan's benefit formula, based on the participant's compensation and years of service) that has accrued under the accrual method provided under the plan. For purposes of these rules, normal retirement age is generally the age specified for normal retirement under the plan, but may not be later than age 65 or, if later, the fifth anniversary of the time a participant commences participation in the plan.<sup>47</sup>

Generally, an employee's accrued benefit must become nonforfeitable (that is, vested) after the completion of a specified number of years of service in accordance with a vesting schedule, or, if earlier, at normal retirement age or on plan termination (to the extent benefits are funded).<sup>48</sup> In the case of a defined benefit plan (other than a hybrid plan), the plan can use one of two vesting schedules with respect to a participant's accrued benefit derived from employer contributions. Under the first vesting schedule, the participant's accrued benefit derived from employer contributions must become 100-percent vested upon completion of no more than five years of service (referred to as five-year cliff vesting). Under the second vesting schedule, the participant's accrued benefit derived from employer contributions must become vested ratably over the period from three to seven years of service. Under a hybrid plan (that is, an "applicable defined benefit plan"), the participant's accrued benefit generally must be 100 percent vested after completion of three years of service (three-year cliff vesting).<sup>49</sup> A plan may provide for the employer-provided portion of the accrued benefit to become fully vested after fewer years of service than under one of the required vesting schedules or to become immediately vested when accrued.

Accrued benefits attributable to employee contributions must be nonforfeitable at all times. Specific rules apply for determining the portion of any accrued benefit under a defined benefit plan that is attributable to mandatory employee contributions.<sup>50</sup>

A defined benefit plan may also provide for certain ancillary benefits, which are not part of the participant's accrued benefit, such as disability or death benefits. Ancillary benefits are not

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<sup>46</sup> Sec. 411 and ERISA secs. 203-204.

<sup>47</sup> Sec. 411(a)(8) and ERISA sec. 3(24).

<sup>48</sup> Certain forfeitures are permitted for accrued benefits that are otherwise fully vested; for example, forfeiture upon the participant's death or withdrawal of mandatory employee contributions and suspension of benefits upon reemployment.

<sup>49</sup> Sec. 411(a)(13) and ERISA sec. 203(f).

<sup>50</sup> Sec. 411(c) and ERISA sec. 204(c).

subject to the vesting requirements or to the accrual or anti-cutback requirements discussed below.

## **Accrual rules**

### **General rules**

In general terms, a participant's accrued benefit represents the benefit that the participant has earned or "accrued" under the plan as of a given time. For example, if a participant terminates employment before reaching normal retirement age, the benefit to which the participant is entitled to receive on reaching normal retirement age is the accrued benefit. The plan must specify the method (referred to as the plan's "accrual method") used to determine the participant's accrued benefit, that is, the portion of a participant's normal retirement benefit that has been earned as of a given time.

Under the accrual rules, participants' accrued benefits under a defined benefit plan must be determined under one of three permissible accrual methods.<sup>51</sup> These rules relate to the pattern in which a participant's normal retirement benefit is earned over the participant's years of service. The accrual rules limit the extent to which benefit accruals can be "backloaded," that is, they limit the extent to which rates of accrual can be higher for later years of service, which could undercut the vesting requirements. The accrual rules are sometimes referred to as the anti-backloading rules.

Reductions in an employee's rate of accrual under a defined benefit plan due to increasing age generally are also prohibited. Special rules apply for purposes of determining whether a hybrid plan satisfies this requirement.

### **Accrual methods**

The three permissible accrual methods are (1) the 133-1/3 percent method, (2) the fractional method, and (3) the three percent method. Most defined benefit plans use the 133-1/3 percent method or the fractional method.

Under the 133-1/3 percent method, (1) the accrued benefit payable at normal retirement age must equal the normal retirement benefit under the plan, and (2) the annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age for any plan year cannot be more than 133-1/3 percent of the annual rate at which he or she can accrue benefits for any earlier plan year. For example, if the plan provides that a participant accrues a benefit of 1.5 percent of compensation for each year of service up to 20 and 2 percent of compensation for each year of service in excess of 20, the plan satisfies the requirements of the 133-1/3 percent method. However, a benefit that accrues at the rate of one percent of compensation for each year of service up to 20 and 1.5 percent of compensation for each year of service in excess of 20 does not satisfy the requirements of the 133-1/3 percent method.

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<sup>51</sup> Sec. 411(b) and ERISA sec. 204(b).

Under the fractional method, the accrued benefit to which a participant is entitled at any time must equal or exceed the participant's "fractional rule benefit," multiplied by a fraction (not exceeding one), the numerator of which is the participant's total years of participation in the plan, and the denominator of which is the total number of years of plan participation the participant would have if he or she separated from service at normal retirement age. A participant's "fractional rule benefit" is the normal retirement benefit to which the participant would be entitled under the plan if the participant attained normal retirement age on the date the benefit is being determined (that is, based on the participant's current amount of compensation and years of service).

The fractional method is illustrated by the following example. Suppose a plan provides a normal retirement benefit at age 65 of two percent of compensation for each year of service up to 30 years, so that a participant with 15 years of service has a fractional rule benefit of 30 percent of compensation (determined as if the participant attained normal retirement age on the date the benefit is being determined). For a participant who began participation in the plan at age 21 and is now age 36, the participant's accrued benefit under the fractional method is the participant's fractional rule benefit (30 percent of compensation), multiplied by the fraction  $15/44$  (that is, the participant's 15 years of participation over the participant's projected years of plan participation at normal retirement age of 65) or 10.23 percent of compensation. For a participant who began participation in the plan at age 35 and is now age 50, the participant's accrued benefit under the fractional method is the participant's fractional rule benefit (30 percent of compensation), multiplied by the fraction  $15/30$  (that is, the participant's 15 years of participation over the participant's projected years of plan participation at normal retirement age of 65) or 15 percent of compensation.

Under the three percent method, the accrued benefit to which each participant is entitled (computed as if the participant separated from the service as of the end of the plan year) must be at least three percent of the "three percent method benefit," multiplied by the participant's years of plan participation as of the end of the year (but not more than  $33 \frac{1}{3}$  years). A participant's "three percent method benefit" is the normal retirement benefit to which the participant would be entitled if he or she began participation at the earliest age possible under the plan and participated in the plan continuously until the earlier of age 65 or the normal retirement age under the plan.

The fractional method and the three percent method provide the minimum rate at which a participant's benefit must accrue. Therefore, a plan may use an accrual method under which participants' accrued benefits exceed the minimum, provided that no participant's accrued benefit can be less than the minimum.

## **Other forms of benefit**

### **Optional forms of benefit**

A defined benefit plan is permitted to provide a wide variety of optional forms in which distribution of the accrued benefit will be made, but each form must provide payments that are not less than the actuarial equivalent of the accrued benefit, or an impermissible forfeiture will occur.

In some cases, a defined benefit plan may provide for an early retirement benefit that is subsidized (that is, it has a greater actuarial value than the normal form of benefit) or another retirement-type subsidy. For example, the normal form of benefit under a plan might be a life annuity commencing at normal retirement age, but the plan may provide an early retirement benefit without a full actuarial reduction in the participant's annuity payments. The right to subsidized forms of benefit is not required to vest or accrue in accordance with the vesting schedules or accrual rules described above. For example, a plan with a normal retirement age of 65 might provide for payment of a participant's accrued benefit at age 55 without actuarial reduction for early commencement, but condition entitlement to the subsidized benefit on retirement from service with the employer after attaining age 55 with at least 30 years of service.

#### Minimum lump-sum calculation

In the case of a distribution from a defined benefit plan of an individual's entire accrued benefit in the form of a single sum (generally referred to as a lump-sum benefit), the amount of the lump-sum benefit generally must not be less than the actuarial present value of the accrued benefit calculated using specified interest rates and a specified mortality table.<sup>52</sup> The specified interest rates (referred to as corporate bond segment rates) are determined by the Treasury Department based on a corporate bond yield curve that reflects the monthly yields on investment grade corporate bonds with varying maturities.<sup>53</sup> The segment rates depend on the timing of the expected payments under a participant's annuity benefit, with the first segment rate applicable to payments that would be made in the next five years, the second segment rate applicable to payments that would be made in the following 15 years, and the third segment rate applicable to payments that would be made thereafter. Thus, the interest rate that applies depends on how many years in the future a participant's annuity payment will be made.

The vesting rules also prohibit a plan from distributing an employee's accrued benefit without the employee's consent (an "involuntary" distribution) before the later of the time the participant has attained normal retirement age under the plan or attained age 62.<sup>54</sup> An exception generally allows a lump-sum distribution without the employee's consent if the present value of the employee's accrued benefit at the time of the distribution is not more than \$5,000 ("mandatory cash-out").<sup>55</sup>

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<sup>52</sup> Sec. 417(e) and ERISA sec. 205(g)(3). These actuarial assumptions are required to determine minimum actuarial equivalent benefits under all forms of benefit other than life annuities. Under sec. 411(a)(13) and ERISA sec. 203(f), subject to certain conditions, an employee's lump-sum benefit under a hybrid plan may be determined as the balance of the employee's hypothetical account.

<sup>53</sup> Corporate bond segment rates apply also in determining minimum required contributions under the funding rules applicable to single-employer plans.

<sup>54</sup> Sec. 411(a)(11) and ERISA sec. 203(e).

<sup>55</sup> As with respect to application of the QJSA and QPSA requirements, for this purpose, the portion of an accrued benefit attributable to amounts that were rolled over to the plan may be disregarded in determining whether present value exceeds \$5,000.

## **Anti-cutback requirements**

In general, a plan amendment may not reduce an employee's accrued benefit (whether or not vested), eliminate an optional form of benefit, or eliminate or reduce early retirement benefits or retirement-type subsidies with respect to the employee's accrued benefit.<sup>56</sup> These restrictions are referred to as the anti-cutback requirements.

If the benefit formula under a defined benefit plan includes a variable factor, variation in the factor in accordance with the plan formula is not an amendment subject to the anti-cutback requirements.<sup>57</sup> However, an amendment substituting a fixed factor, or another variable factor, for the variable factor is subject to the anti-cutback requirements.

Amendments generally are permitted only to reduce future rates of accrual, or, in the case of optional forms of benefits, early retirement benefits and retirement-type subsidies, eliminate or reduce them only with respect to benefits that accrue after the amendment. However, as discussed below, certain benefits may be reduced or eliminated in the case of an underfunded multiemployer defined benefit plan. In addition, Treasury regulations may provide exceptions to the prohibition on eliminating an optional form of benefit.

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<sup>56</sup> Sec. 411(d)(6) and ERISA sec. 204(g).

<sup>57</sup> Rev. Rul. 81-12, 1981-1 C.B. 228.

## **C. Exceptions to the Anti-Cutback Requirements for Certain Multiemployer Plans**

### **1. Multiemployer plans in critical status**

Not later than the 90th day of each plan year, the actuary for any multiemployer plan must certify to the Secretary of the Treasury and to the plan sponsor whether or not the plan is in endangered or critical status for the plan year.<sup>58</sup> If a plan is certified as being in endangered or critical status, notice of endangered or critical status must be provided within 30 days after the date of certification to plan participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor.<sup>59</sup> If a plan is in critical status,<sup>60</sup> the notice of critical status must include an explanation of the possibility that adjustable benefits may be reduced (as discussed below) for participants and beneficiaries whose benefit commencement date is on or after the date the notice is provided for the first plan year for which the plan is in critical status.

In the case of a multiemployer plan in critical status, notwithstanding the anti-cutback rules, certain distributions may not be made as of the date notice of critical status is sent to participants and beneficiaries; thus, those forms of distribution may be eliminated. Specifically, payments in excess of a single life annuity (plus any social security supplement, if applicable) may not be made to a participant or beneficiary who begins receiving benefits after the notice is sent.

In addition, subject to providing advance notice, notwithstanding the anti-cutback rules, the plan sponsor of a plan in critical status may make certain reductions to adjustable benefits that the plan sponsor deems appropriate.<sup>61</sup> However, benefits generally may not be reduced for a participant or beneficiary who began to receive benefits before receiving notice of the multiemployer plan's critical status.

Adjustable benefits means (1) benefits, rights, and features under the plan, including post-retirement death benefits, 60-month guarantees, disability benefits not yet in pay status, and similar benefits; (2) any early retirement benefit or retirement-type subsidy and any benefit payment option (other than the QJSA); and (3) benefit increases that would not be eligible for PBGC guarantee on the first day of the initial critical year because the increases were adopted (or, if later, took effect) less than 60 months before such first day. Adjustable benefits that are otherwise protected under the anti-cutback rules, such as early retirement benefits, retirement-

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<sup>58</sup> The rules for multiemployer plans in endangered or critical status are discussed in Part I.D.3. These rules were enacted by the Pension Protection Act of 2006 ("PPA"), Pub. L. No. 109-280, effective for plan years beginning after 2007, and were amended by the Multiemployer Pension Reform Act of 2014 ("MPRA"), Division O of Pub. L. No. 113-235.

<sup>59</sup> Copies of critical, critical and declining, endangered and WRERA status notices are available at <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/public-disclosure/critical-status-notice>.

<sup>60</sup> See Part I.D.3 for the definition of critical status.

<sup>61</sup> In some circumstances, reductions in adjustable benefits may be required in order to enable a multiemployer plan to meet the requirements of its rehabilitation plan, discussed in Part I.D.3.

type subsidies and optional forms of benefit, may be reduced notwithstanding the anti-cutback rules. However, the level of a participant's accrued benefit payable at normal retirement age may not be reduced.

No adjustable benefits may be reduced unless 30 days advance notice is given to plan participants and beneficiaries, any employer that has an obligation to contribute to the plan, and any employee organization that, in collective bargaining, represents plan participants employed by a contributing employer. The notice must contain sufficient information to enable participants and beneficiaries to understand the effect of any reduction of their benefits, including an estimate (on an annual or monthly basis) of any affected adjustable benefit that a participant or beneficiary would otherwise have been eligible for, and information as to the rights and remedies of plan participants and beneficiaries as well as how to contact DOL for further information and assistance where appropriate.

The required notice must be provided in a form and manner prescribed by the Secretary in consultation with the Secretary of Labor, must be written in a manner so as to be understood by the average plan participant, and may be provided in written, electronic, or other appropriate form to the extent such form is reasonably accessible to persons to whom the notice is required to be provided. The Secretary is to establish a model notice that a plan sponsor may use to meet the notice requirements.

## **2. Multiemployer plans in insolvency**

Benefits under a multiemployer plan may be suspended (that is, reduced) if the plan is insolvent.<sup>62</sup> A multiemployer plan is insolvent when its available resources in a plan year are not sufficient to pay the plan benefits for that plan year, or when the sponsor of a plan in critical status reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources will not be sufficient to pay benefits that come due in the next plan year.

Notwithstanding the anti-cutback rules, an insolvent plan is required to reduce benefits to the level that can be covered by the plan's assets. Notice of the benefit reductions must be provided to the participants and beneficiaries, the bargaining parties, the Secretary of the Treasury, and the PBGC. In general, the suspension of benefits must apply in substantially uniform proportions to the benefits of all persons (participants and beneficiaries) in pay status.<sup>63</sup> Under an insolvent plan, benefits cannot be reduced below the level guaranteed under the PBGC's multiemployer plan program. The PBGC benefit guarantee level for a participant in a multiemployer plan is the sum of 100 percent of the first \$11 of vested monthly benefits and 75 percent of the next \$33 of vested monthly benefits, multiplied by the participant's number of years of service.

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<sup>62</sup> Sec. 418E and ERISA sec. 4245.

<sup>63</sup> The Secretary has the authority to prescribe rules under which benefit suspensions for different participant groups may be varied equitably to reflect variations in contribution rates and other relevant factors including differences in negotiated levels of financial support for plan benefit obligations.

If a multiemployer plan is insolvent, the PBGC guarantee is provided in the form of unsecured loans to the plan (referred to as financial assistance), regardless of the plan's ability to repay the loan. However, if a plan were later to recover from insolvency status, loans from the PBGC would have to be repaid.

### **3. Multiemployer plans in critical and declining status under the Multiemployer Pension Reform Act of 2014 (“MPRA”)**

#### **In general**

Subject to certain conditions, limitations and procedural requirements, including approval by the Secretary of Treasury as described below, in the case of a multiemployer plan in critical and declining status, notwithstanding the anti-cutback rules, the plan sponsor may amend the plan to suspend benefits that the plan sponsor deems appropriate.<sup>64</sup> In that case, the plan is not liable for any benefit payments not made as a result of a suspension of benefits.

In the annual certification of whether a multiemployer plan is in endangered or critical status for a plan year, the plan actuary must also certify whether the plan is or will be in critical and declining status for the plan year.<sup>65</sup> A plan is in critical and declining status if the plan (1) otherwise meets one of the definitions of critical status and (2) is projected to become insolvent during the current plan year or any of the 14 succeeding plan years. In applying (2), 19 succeeding plan years is substituted for 14 if either the ratio of inactive plan participants to active plan participants is more than two to one or the plan's funded percentage is less than 80 percent.

For purpose of these rules, suspension of benefits means the temporary or permanent reduction of any current or future payment obligation of the plan to any plan participant or beneficiary, whether or not the participant or beneficiary is in pay status at the time of the suspension. Any suspension of benefits made will remain in effect until the earlier of when the plan sponsor provides benefit improvements as described below or when the suspension expires by its own terms. Thus, unless the terms of the suspension of benefits provide for the suspension to expire (and for benefits to return to the same level as before the suspension), a suspension of benefits may result in a permanent benefit reduction.

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<sup>64</sup> The rules for plans in critical and declining status were enacted by MPRA, effective December 16, 2014, the date of enactment of MPRA. The Department of the Treasury issued final regulations under these rules on April 28, 2016 and on May 5, 2016. See T.D. 9765, 81 Fed. Reg. 82, at 25539, Final regulations and removal of temporary regulations; and T.D. 9767, 81 Fed. Reg. 87, at 27011, Final regulations. Under Reorganization Plan No. 4 of 1978, 43 Fed. Reg. 47713, October 17, 1978, the regulations apply for purposes of both the Code and ERISA.

<sup>65</sup> If a plan is certified to be in critical and declining status, the annual funding notice required under ERISA section 101(f) with respect to a multiemployer plan must include (1) whether the plan was in critical and declining status for the plan year and if so, (2) the projected date of insolvency, (3) a clear statement that such insolvency may result in benefit reductions, and (4) a statement describing whether the plan sponsor has taken legally permitted actions to prevent insolvency. The annual funding notice must be provided to plan participants and beneficiaries, the bargaining parties, and the PBGC within 120 days after the end of the plan year to which the notice relates.

## **Conditions for suspensions**

In addition to the procedural requirements described below, two conditions must be met in order for the plan sponsor of a multiemployer plan in critical and declining status for a plan year to suspend benefits:

1. Taking into account the proposed suspensions of benefits (and, if applicable, a proposed partition of the plan under ERISA<sup>66</sup>), the plan actuary certifies that the plan is projected to avoid insolvency, assuming the suspensions of benefits continue until the suspensions expire by their own terms or, if no specific expiration date is set by the terms, indefinitely; and
2. The plan sponsor determines, in a written record to be maintained throughout the period of the suspension of benefits, that, although all reasonable measures to avoid insolvency have been taken (and continue to be taken during the period of the benefit suspensions), the plan is still projected to become insolvent unless benefits are suspended.

In making the determination described above, the plan sponsor may take into account factors including the following:

- current and past contribution levels,
- levels of benefit accruals, including any prior reductions in the rate of benefit accruals,
- prior reductions of adjustable benefits, if any,
- prior suspensions of benefits, if any,
- the impact on plan solvency of the subsidies and ancillary benefits available to active participants,
- compensation levels of active participants relative to employees in the participants' industry generally,
- competitive and other economic factors facing contributing employers,
- the impact of benefit and contribution levels on retaining active participants and bargaining groups under the plan,
- the impact of past and anticipated contribution increases under the plan on employer attrition and retention levels, and
- measures undertaken by the plan sponsor to retain or attract contributing employers.

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<sup>66</sup> The partition rules are discussed in Part I.E.3.

## **Application of and limitations on suspensions**

In general, any suspensions of benefits must be equitably distributed across the plan participant and beneficiary population, taking into account factors (with respect to the participants and beneficiaries and their benefits) that may include one or more of the following:

- age and life expectancy,
- length of time in pay status,
- amount of benefit,
- type of benefit, such as survivor, normal retirement, early retirement,
- the extent to which a participant or beneficiary is receiving a subsidized benefit,
- the extent to which a participant or beneficiary has received post-retirement benefit increases,
- any history of benefit increases and reductions,
- the number of years to retirement for active employees,
- any discrepancies between active and retiree benefits,
- the extent to which active participants are reasonably likely to withdraw support for the plan, accelerating employer withdrawals from the plan and increasing the risk of additional benefit reductions for participants in and not in pay status, and
- the extent to which benefits are attributable to service with an employer that failed to pay its full withdrawal liability.

In addition to these factors, any suspensions of benefits are subject to an aggregate limit and several limits at the individual level. Specifically, in the aggregate (considered, if applicable, in combination with a partition of the plan), any suspensions of benefits must be at the level reasonably estimated to achieve, but not materially exceed, the level that is necessary to avoid insolvency.<sup>67</sup>

At the individual level, no benefits based on disability (as defined under the plan) may be suspended. In addition, the monthly benefit of any participant or beneficiary may not be reduced below 110 percent of the monthly PBGC guarantee level, as determined for that participant or beneficiary.

In the case of a participant or beneficiary who is age 75 or over as of the effective date of the benefit suspension, the amount of the benefit suspension is phased out ratably over the number of months until age 80, with the result that no benefit suspension applies to a participant or beneficiary who, as of the effective date of the benefit suspension, is age 80 or older. Specifically, for a participant or beneficiary who is between age 75 and 80 as of the effective date of the benefit suspension, not more than the applicable percentage of the participant's or

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<sup>67</sup> If suspensions of benefits under a plan are made in combination with a partition of the plan, the suspensions may not take effect before the effective date of the partition.

beneficiary's maximum suspendable benefits may be suspended. For this purpose, the applicable percentage for a participant or beneficiary is obtained by dividing (1) the number of months during the period beginning with the month after the month containing the effective date of the suspension and ending with the month in which the participant or beneficiary attains the age of 80, by (2) 60 months. Thus, the applicable percentage is determined on the basis of a participant's or beneficiary's age as of the effective date of the benefit suspension and does not change as the participant or beneficiary gets older. A participant's or beneficiary's maximum suspendable benefits is the portion of the participant's or beneficiary's benefits that would otherwise be suspended if the applicable percentage limitation did not apply.<sup>68</sup> For example, if a participant is exactly age 77 (that is, age 77 and zero months) as of the effective date of the benefit suspension, with a period of 36 months until attainment of age 80, the participant's applicable percentage is 36/60 or 60 percent, and the amount of the suspension of benefits applied to the participant is 60 percent of the portion of the participant's benefits that would otherwise be suspended.

Besides these limitations, an ordering rule applies if benefits under a multiemployer plan include benefits that are directly attributable to a participant's service with an employer that, before the date of enactment of the critical and declining rules, (1) withdrew from the plan in a complete withdrawal and paid the full amount of its withdrawal liability,<sup>69</sup> and (2) pursuant to a collective bargaining agreement, assumed liability for providing benefits to plan participants and beneficiaries under a separate, single-employer plan sponsored by the employer, in the amount by which those participants' and beneficiaries' benefits under the multiemployer plan are reduced as a result of the financial status of the multiemployer plan.<sup>70</sup> In that case, suspensions of benefits are applied: first, to the maximum extent permissible, to benefits attributable to service with an employer that withdrew from the plan and failed to pay (or is delinquent in paying) the full amount of its withdrawal liability and before reductions are permitted to be applied to any other benefits; second, to all other benefits that may be suspended, other than those in the following (third) category; and third, to benefits directly attributable to service with an employer described in the preceding sentence. However, the benefits under the second category are not required to be suspended to the maximum extent permissible before any suspension is permitted to be applied to benefits under the third category.<sup>71</sup>

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<sup>68</sup> The maximum suspendable benefits does not mean a participant's or beneficiary's entire benefit, but only the portion of the benefit that would otherwise be suspended under the proposed suspensions of benefits, taking into account the other rules applicable to benefit suspensions. For example, in determining the portion of a participant's or beneficiary's benefit that would otherwise be suspended, the prohibition on reducing benefits below 110 percent of the PBGC guarantee level is taken into account.

<sup>69</sup> For purposes of the ordering rule, the full amount of an employer's withdrawal liability with respect to a plan is determined under the withdrawal liability rules under ERISA or an agreement with the plan sponsor, whichever is applicable.

<sup>70</sup> The ordering rule does not apply if benefits under a multiemployer plan do not include benefits directly attributable to service with such an employer.

<sup>71</sup> Treas. Reg. sec. 1.432(e)(9)-1(d)(8). The regulations clarify that a suspension does not violate the required relationship between benefits under the third and second categories if no individual's benefits under the

## **Benefit improvements**

Several requirements apply with respect to benefit improvements under a multiemployer plan while a suspension of benefits under the plan is in effect. For this purpose, a benefit improvement means a resumption of suspended benefits, an increase in benefits, an increase in the rate at which benefits accrue under the plan, or an increase in the rate at which benefits vest under the plan. Except for resumptions of suspended benefits as discussed below, any limit on benefit improvements while a suspension of benefits is in effect is in addition to any other applicable limits imposed on a plan with respect to benefit increases.

Subject to certain conditions, the plan sponsor may, in its sole discretion, provide benefit improvements while any suspension of benefits remains in effect. However, the plan sponsor may not increase the liabilities of the plan by reason of a benefit improvement for any participant or beneficiary who is not in pay status by the first day of the plan year for which the benefit improvement takes effect (referred to herein as the “benefit improvement year”) unless (1) the benefit improvement is accompanied by equitable benefit improvements (as described below) for all participants and beneficiaries who are in pay status before the first day of the benefit improvement year, and (2) the plan actuary certifies that, after taking any benefit improvements into account, the plan is projected to avoid insolvency indefinitely.

In order to satisfy (1) above, the present value of the total liabilities attributable to benefit improvements for participants and beneficiaries who are not in pay status by the first day of the benefit improvement year (with this present value determined as of that day) may not exceed the present value of the liabilities attributable to benefit improvements for participants and beneficiaries who are in pay status before the first day of the benefit improvement year (with this present value also determined as of that day). In addition, with respect to the required benefit improvements for participants and beneficiaries who are in pay status before the first day of the benefit improvement year, the plan sponsor must equitably distribute any increase in total liabilities attributable to the benefit improvements to some or all of those participants and beneficiaries, taking into account the factors relevant in equitably distributing benefit suspensions among participants and beneficiaries (as described above) and the extent to which the benefits of the participants and beneficiaries were suspended.

Benefit improvements only for participants and beneficiaries in pay status are permitted. However, a plan sponsor may increase plan liabilities through a resumption of benefits for participants and beneficiaries in pay status only if the plan sponsor equitably distributes the value of resumed benefits to some or all of the participants and beneficiaries in pay status, taking into account the factors relevant in equitably distributing benefit suspensions among participants and beneficiaries (as described above).

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third category are reduced more than that individual’s benefits would have been reduced if, holding constant the benefit formula, work history, and all other relevant factors used to determine the individual’s benefits, those benefits were attributable to service with any other employer. In addition, the regulations clarify that benefits under the third category are any benefits directly attributable to a participant’s service with the employer, without regard to whether the employer has assumed liability for providing benefits to the participant or beneficiary that were reduced as a result of the financial status of the plan under a make-whole agreement.

The requirements with respect to benefit improvements do not apply to a resumption of suspended benefits or a plan amendment that increases liabilities with respect to participants and beneficiaries not in pay status by the first day of the benefit improvement year that (1) the Secretary (in consultation with the PBGC and the Secretary of Labor) determines to be reasonable and that provides for only de minimis increases in plan liabilities, or (2) is required as a condition of qualified retirement plan status under the Code or to comply with other applicable law, as determined by the Secretary.

### **Procedural requirements for suspension of benefits**

#### **In general**

A series of procedural steps must be taken and certain approvals must be obtained before any proposed suspension of benefits under a multiemployer plan in critical and declining status may be implemented by the plan sponsor. Below is a summary of these procedural steps and approvals. The approval procedures for a proposed suspension of benefits are administered by the Treasury. However, every step of the process requiring action by Treasury is required to be done in consultation with the PBGC and the DOL. Thus, all references below to Treasury with respect to these procedures include this required consultation with the PBGC and DOL (including references to information to be provided in required notices).

- Not less than 60 days before submitting an application to Treasury for approval of proposed benefit suspensions, the plan sponsor must appoint a retiree representative if the plan has more than 10,000 participants.
- Plan sponsor submits an application to Treasury for approval of the proposed benefit suspensions. Concurrently with submitting the application, the plan sponsor must provide certain parties (which include plan participants) notice of the application and the proposed benefit suspensions.
- Within 30 days after receipt of the application, Treasury must publish the application on the Treasury website and publish notice requesting comments on the application in the Federal Register.
- Within 225 days after receipt of the application, Treasury must approve or disapprove the application, or the application is deemed to be approved in the absence of an affirmative decision. If the application is denied by Treasury at this step, then the suspension of benefits cannot be implemented and the process does not continue.
- Within 30 days after the approval, if the application is approved, or deemed approved, by Treasury, Treasury must administer a participant and beneficiary vote on the proposed benefit suspension.
- Within 7 days after the vote, unless a majority of participants and beneficiaries vote to reject the proposed benefit suspensions (“negative vote”), Treasury must issue a final authorization to allow implementation of the benefit suspensions.
- Within 14 days after a negative vote, Treasury must determine whether the plan is systemically important. In the event of a negative vote, the benefits suspensions cannot be implemented unless the plan is systemically important.

- Within 90 days after a negative vote with respect to a plan determined to be systemically important, Treasury must issue a final authorization permitting benefit suspensions to be implemented by the plan sponsor and in sufficient time to allow implementation before the end of this 90 day period, but can impose modifications to the proposed suspensions.

#### Appointment of retiree representative

If a multiemployer plan has 10,000 or more participants (as of the end of the plan year for the most recently filed Form 5500, “Annual Return/Report of Employee Benefit Plan”), the plan sponsor is required to appoint a participant of the plan in pay status to act as a retiree representative to advocate for the interests of the retired and deferred vested participants and beneficiaries of the plan throughout the suspension approval process.<sup>72</sup> The appointment must be made no later than 60 days before the plan sponsor submits an application to Treasury for approval of proposed benefit suspensions. The plan is required to provide for reasonable expenses by the retiree representative, including reasonable legal and actuarial support, commensurate with the plan’s size and funded status. Duties performed by the retiree representative are not subject to prohibited transaction rules under the Code and the fiduciary responsibility requirements under ERISA.<sup>73</sup> However, this relief from fiduciary responsibility does not apply to those duties associated with an application to suspend benefits that are performed by a retiree representative who is also a plan trustee.

#### Plan sponsor notice of application for Treasury approval of proposed suspension

The first step in satisfying the procedural requirements for being allowed to implement proposed benefit suspensions (after appointing a retiree representative if applicable) is applying to Treasury for approval of the proposed suspensions, as described below.<sup>74</sup> Concurrently with submitting that application, the plan sponsor must provide a notice to plan participants and beneficiaries, employers with an obligation to contribute to the plan and any employee organization representing participants employed by the employers. The notice must contain the following information:<sup>75</sup>

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<sup>72</sup> Sec. 432(e)(9)(B)(v) and Treas. Reg. sec. 1.432(e)(9)-1(b)(4). A deferred vested participant is a participant who has a vested benefit under the plan, is no longer accruing benefits under the plan, and has not yet begun receiving benefits. In the discretion of the plan sponsor, the retiree representative may continue in this role throughout the period of the benefit suspension.

<sup>73</sup> Sec. 4975 and ERISA sec. 404(a).

<sup>74</sup> Application procedures are provided in Rev. Proc. 2016-27, 2016-19 I.R.B. 725, issued May 9, 2016.

<sup>75</sup> Sec. 432(e)(9)(F)(ii) and Treas. Reg. sec. 1.432(e)(9)-1(f).

- sufficient information to enable participants and beneficiaries to understand the effect of any suspensions of benefits, including an individualized estimate (on an annual or monthly basis) of such effect on each participant or beneficiary,<sup>76</sup>
- a description of the factors considered by the plan sponsor in designing the benefit suspensions;
- a statement that the application for approval of any suspension of benefits will be available on the Treasury website and that comments on the application will be accepted;
- information as to the rights and remedies of plan participants and beneficiaries;
- if applicable, a statement describing the appointment of a retiree representative, the date of appointment of the representative, identifying information about the retiree representative (including whether the representative is a plan trustee), and how to contact the representative;
- a statement that the plan sponsor has determined that the plan will become insolvent unless the proposed suspension takes effect, and the year in which insolvency is projected to occur without a suspension of benefits (and, if applicable, a proposed partition);
- a statement that insolvency of the plan could result in benefits lower than benefits paid under the proposed suspension and a description of the projected benefit payments upon insolvency;
- a description of the proposed suspension and its effect, including a description of the different categories or groups affected by the suspension, how those categories or groups are defined, and the formula that is used to calculate the amount of the proposed suspension for individuals in each category or group;
- a description of the effect of the proposed suspension on the plan's projected insolvency;
- a description of whether the suspension will remain in effect indefinitely or will expire by its own terms;
- a statement describing the right to vote on the suspension application; and
- information on how to contact Treasury for further information and assistance where appropriate.

The notice must be provided in a form and manner prescribed in guidance by Treasury. It must be written in a manner so as to be understood by the average plan participant. It may be provided in written, electronic, or other appropriate form to the extent such form is reasonably

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<sup>76</sup> If it is not possible to provide an individualized estimate on an annual or monthly basis of the quantitative effect of the suspension on a participant or beneficiary, such as in the case of a suspension that affects the payment of any future cost-of-living adjustment, a narrative description of the effect of the suspension must be provided.

accessible to persons to whom the notice is required to be provided.<sup>77</sup> Treasury is directed to publish a model notice that a plan sponsor may use to meet these requirements.<sup>78</sup>

#### Public notice of the application by Treasury

The application for approval of the suspension of benefits must be published on the Treasury website.<sup>79</sup> In addition, not later than 30 days after receipt of the application, Treasury must publish a notice in the Federal Register soliciting comments from contributing employers, employee organizations, and participants and beneficiaries of the plan for which an application was made.

#### Approval procedures by Treasury

Treasury must approve the plan sponsor's application for a suspension of benefits upon finding that the plan is eligible for the suspensions and has satisfied the criteria, as previously described, for suspending benefits, limitations on suspensions, and benefit improvements (if any) during suspension and has provided the required notice of the proposed suspensions.

In general, in evaluating an application, Treasury is to accept a plan sponsor's determinations unless Treasury concludes that the plan sponsor's determinations were clearly erroneous. As previously discussed, as a condition for benefit suspensions, the plan sponsor must determine that, although all reasonable measures to avoid insolvency have been taken (and continue to be taken during the period of the benefit suspensions), the plan is still projected to become insolvent unless benefits are suspended. The plan sponsor may take various factors into account in making this determination. In evaluating whether the plan sponsor has met the criteria for its required determination, Treasury must review the plan sponsor's consideration of relevant factors.

Treasury is directed to approve or deny the application within 225 days of the submission by the plan sponsor, and the application for suspension of benefits is deemed approved unless, within such 225 days, Treasury notifies the plan sponsor that it has failed to satisfy one or more of the criteria for approval.<sup>80</sup>

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<sup>77</sup> Section 4980F of the Code and section 204(h) of ERISA require notice of any amendment to significantly reduce the rate of future benefit accrual under a pension plan to be provided to affected plan participants and alternate payees (and employee organizations representing these participants and alternate payees and participating employers) within a reasonable time before the amendment is effective. The notice of the application fulfills the requirement for providing notice of a significant reduction in the future rate of benefit accrual

<sup>78</sup> Rev. Proc. 2016-27 includes a model notice.

<sup>79</sup> Applications are published at <https://www.treasury.gov/services/Pages/Plan-Applications.aspx>.

<sup>80</sup> Treas. Reg. sec. 1.432(e)(9)-1(g)(3)(iv) provides that the Treasury and the sponsor may mutually agree in writing to stay the 225-day period.

If Treasury rejects a plan sponsor's application, Treasury must provide notice to the plan sponsor detailing the specific reasons for the rejection, including reference to the specific requirement not satisfied.

#### Participant vote to ratify or reject the proposed suspensions

Not later than 30 days after Treasury approves the proposed benefit suspension, Treasury must administer a vote of plan participants and beneficiaries. No suspension of benefits may take effect prior to a vote of the plan participants and beneficiaries with respect to the proposed benefit suspension.

The plan sponsor is required to provide a ballot for the vote (subject to approval by Treasury) that includes the following statements:

- from the plan sponsor in support of the suspension,
- in opposition to the suspension compiled from comments received pursuant to the Notice published in the Federal Register (as described above),
- that the suspension has been approved by Treasury,
- that the plan sponsor has determined that the plan will become insolvent unless the suspension takes effect,
- that insolvency of the plan could result in benefits lower than benefits paid under the suspension, and
- that insolvency of the PBGC would result in benefits lower than benefits paid in the case of plan insolvency.

The ballot must be written in a manner readily understandable by the average plan participant, and may not include false or misleading information (or omit information in a manner that causes the information provided to be misleading). The ballot must be approved by Treasury.

A negative vote occurs only if a majority of all plan participants and beneficiaries vote to reject the proposed benefit suspensions ("negative vote").<sup>81</sup> The suspension goes into effect following the vote if the result is not a negative vote. In that case, not later than seven days after the vote, Treasury must issue a final authorization of the suspension.

If the result is a negative vote, the plan sponsor may not implement the benefit suspension unless the plan is systemically important. However, after a negative vote with respect to a plan that is not systemically important, the plan sponsor may start the process again by developing different proposed benefit suspensions, subject to the conditions applicable to benefits suspensions, and submitting a new application for approval to Treasury.

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<sup>81</sup> Thus, a participant's or beneficiary's failure to vote has the effect of a vote in favor of the benefit suspension.

### Systemically important plan

Not later than 14 days after a negative vote, Treasury must determine whether the plan is a systemically important plan. A systemically important plan is a plan with respect to which the PBGC projects that, if suspensions are not implemented, the present value of projected financial assistance payments exceeds \$1 billion (indexed).<sup>82</sup> Not later than 30 days after a determination by Treasury that the plan is systemically important, if applicable, the Participant and Plan Sponsor Advocate (“Advocate”)<sup>83</sup> may submit recommendations to Treasury with respect to the proposed benefit suspensions or any revisions to the proposed suspensions.

If Treasury determines that the plan is a systemically important plan, not later than the end of the 90-day period beginning on the date the results of the vote are certified, Treasury must, notwithstanding the negative vote, issue a final authorization either:

- permitting the implementation of the benefit suspensions proposed by the plan sponsor, or
- permitting the implementation of a modification by Treasury of the benefit suspensions (giving consideration to any recommendations submitted by the Advocate), provided that the plan is projected to avoid insolvency under the modification.

However, Treasury must issue the final authorization at a time sufficient to allow implementation of the benefit suspension before the end of the 90-day period. Thus, the deadline for issuance of the final authorization of the suspension is actually earlier than the end of the 90-day period.

### Appeal of decisions

For purposes of judicial review of agency action, approval or denial by Treasury of an application is treated as a final agency action.<sup>84</sup>

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<sup>82</sup> This determination is expected to be made using the assumptions that PBGC generally uses in evaluating the financial position of its multiemployer program. For calendar years beginning after 2015, the \$1 billion is indexed by reference to the change in the wage base applicable for purposes of Social Security taxes and benefits since 2014. If the amount otherwise determined under this calculation is not a multiple of \$1 million, the amount is rounded to the next lowest multiple of \$1 million.

<sup>83</sup> The Advocate is selected under section 4004 of ERISA.

<sup>84</sup> Rules for judicial review of agency action are provided at 5 U.S.C. chap. 7 (part of the Administrative Procedure Act). These rules are not specifically applicable to Treasury’s approval or denial of an application for benefit suspensions. However, under 5 U.S.C. sec. 701, these rules apply except to the extent that statutes preclude judicial review or agency action is committed to agency discretion by law. Pursuant to 5 U.S.C. sec. 704, agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review under these rules.

An action by a plan sponsor challenging the denial of an application for suspension of benefits by Treasury may only be brought following the denial. An action challenging a suspension of benefits may only be brought following a final authorization to suspend by Treasury. A participant or beneficiary affected by a benefit suspension does not have a cause of action under the Code or Title I of ERISA.<sup>85</sup> No action challenging a suspension of benefits following the final authorization to suspend or the denial of an application for suspension of benefits may be brought after one year after the earliest date on which the plaintiff acquired or should have acquired actual knowledge of the existence of the cause of action.

A court review of an action challenging a suspension of benefits is to be done in accordance with the rules for judicial review of agency actions.<sup>86</sup> A court reviewing an action challenging a suspension of benefits may not grant a temporary injunction with respect to the suspension unless the court finds a clear and convincing likelihood that the plaintiff will prevail on the merits of the case.

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<sup>85</sup> A participant or beneficiary might otherwise have a cause of action against the plan sponsor under ERISA section 502 with respect to the benefit suspension.

<sup>86</sup> In reviewing an agency action, under 5 U.S.C. sec. 706, the reviewing court is to decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court is to set aside agency action in certain circumstances, such as when found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. In making its determinations, the court is to review the whole record, or those parts of it cited by a party, and due account is to be taken of the rule of prejudicial error.

## D. Funding and Deduction Rules for Multiemployer Defined Benefit Plans

### 1. In general

#### Funding requirements and waivers

Employer contributions to a defined benefit plan are subject to minimum funding requirements to ensure that plan assets are sufficient to pay the benefits under the plan.<sup>87</sup> In the case of a multiemployer plan, the amount of required annual contributions is determined under certain actuarial methods, and additional rules apply in the case of a plan in endangered or critical status.<sup>88</sup> Minimum required contributions for a plan year must generally be made no later than 8½ months after the end of the plan year.

In general, an employer is subject to a two-tier excise tax for a failure to make required contributions unless a funding waiver is obtained.<sup>89</sup> The initial tax is five percent of the plan's accumulated funding deficiency in the case of a multiemployer plan. (However, as discussed below, in the case of a multiemployer plan in critical status, the excise tax does not apply, subject to compliance with the requirements for a plan in critical status.) An additional tax is imposed if the failure is not corrected before the date that a notice of deficiency with respect to the initial tax is mailed to the employer by the IRS or the date of assessment of the initial tax. The additional tax is equal to 100 percent of the accumulated funding deficiency.

Within limits, the IRS is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year (a "funding" waiver).<sup>90</sup> In the case of a multiemployer plan, a funding waiver may be granted if 10 percent or more of the employers responsible for the contribution could not make the required contribution without substantial business hardship. In addition, a funding waiver may be granted only if requiring the contribution would be adverse to the interests of plan participants in the aggregate. Generally, no more than five waivers may be granted to a multiemployer plan within any period of 15 consecutive plan years. Additional requirements apply, including notice to participants and the PBGC, and restrictions on benefit increases, as well as conditions that the IRS may require.

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<sup>87</sup> The funding rules generally do not apply to governmental or church plans.

<sup>88</sup> Secs. 412 and 431-432 and ERISA secs. 302 and 304-305. For a description of the funding rules applicable to single-employer defined benefit plans, see Joint Committee on Taxation, *Present Law and Background Relating to Qualified Defined Benefit Plans* (JCX-99-14), September 15, 2014, Part I.D.2, available at [www.jct.gov](http://www.jct.gov).

<sup>89</sup> Sec. 4971.

<sup>90</sup> Sec. 412(c).

## **Deduction limit**

The Code limits the amount of employer contributions to a defined benefit plan that may be deducted for a year.<sup>91</sup> The deduction limit for employer contributions to a multiemployer plan is generally the excess of (1) 140 percent of the plan's current liability (the present value of all benefits earned under the plan, determined using specified interest and mortality assumptions), over (2) the value of plan assets. However, the deduction limit is never less than the contributions required for the year under the minimum funding rules. The deduction limit applies to the total contributions made by all employers participating in the multiemployer plan.

If contributions exceed the amount deductible, an excise tax generally applies, in the amount of 10 percent of the excess for each year the excess remains in the plan.<sup>92</sup> The excise tax is allocated among the employers that contribute to the multiemployer plan.

## **2. General funding rules for multiemployer plans**

### **Minimum required contributions**

In connection with the funding requirements, a multiemployer defined benefit plan maintains a notional account called a "funding standard account" to which specific charges and credits (including plan contributions) are made for each plan year the multiemployer plan is maintained. The minimum required contribution for a plan year is the amount, if any, needed so that the accumulated credits to the funding standard account as of that plan year are not less than the accumulated charges (that is, so the funding standard account does not have a negative balance). If, as of the close of a plan year, accumulated charges to the funding standard account exceed credits, the plan has an "accumulated funding deficiency" equal to the amount of the excess. For example, if, as of a plan year, the balance of charges to the funding standard account would be \$200,000 without any contributions, then a minimum contribution equal to that amount is required to meet the minimum funding standard for the year (that is, to prevent an accumulated funding deficiency). If credits to the funding standard account exceeds charges, a "credit balance" results. The amount of the credit balance, increased with interest, reduces future required contributions.

### **Funding method; charges and credits to the funding standard account**

A multiemployer plan is required to use an acceptable actuarial cost method (referred to as a funding method) to determine the elements included in its funding standard account for a year. Generally, an actuarial cost method breaks up the cost of benefits under the plan into annual charges to the funding standard account consisting of two elements for each plan year. These elements are referred to as: (1) normal cost and (2) supplemental cost.

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<sup>91</sup> Sec. 404.

<sup>92</sup> Sec. 4972. If contributions for a subsequent year are less than the deduction limit for that year, the difference reduces the excess contributed for the previous year, thus reducing the amount taken into account for purposes of the excise tax for the subsequent year.

The plan's normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount actuarially determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions (such as interest and mortality) had been fulfilled. A plan's normal cost for a plan year is charged to the funding standard account for that year.

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan: (1) on the date the plan is first effective; or (2) on the date a plan amendment increasing plan benefits is first effective. Other supplemental costs may be attributable to net experience losses (for example, worse than expected investment returns or actuarial experience), losses from changes in actuarial assumptions, and amounts necessary to make up funding deficiencies for which a waiver was obtained. Supplemental costs are amortized (that is, recognized for funding purposes) over a specified number of years (generally 15 years) by annual charges to the funding standard account over that period.<sup>93</sup>

Factors that result in a supplemental loss can alternatively result in a gain that is recognized by annual credits to the funding standard account over a 15-year amortization period (in addition to a credit for contributions made each the plan year). These include a reduction in plan liabilities as a result of a plan amendment decreasing plan benefits, net experience gains (for example, better than expected investment returns or actuarial experience), and gains from changes in actuarial assumptions.

### **Actuarial assumptions; value of plan assets**

In applying the funding rules to a multiemployer plan, all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations). In addition, the assumptions are required to offer the actuary's best estimate of anticipated experience under the plan. The interest rate used in multiemployer plan funding computations, which represents the expected return on plan assets over time, and the mortality assumptions used are subject to these general standards.

For funding purposes, the actuarial value of plan assets may be used, rather than fair market value. The actuarial value of plan assets is the value determined under a reasonable actuarial valuation method that takes into account fair market value and is permitted under Treasury regulations. Any actuarial valuation method used generally must result in a value of plan assets that is not less than 80 percent of the fair market value of the assets and not more than 120 percent of the fair market value. In addition, if the valuation method uses average value of

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<sup>93</sup> If certain requirements are met, the IRS may grant an extension of up to ten years of the amortization period used in determining certain charges to the funding standard account. In some circumstances, a five-year extension is automatic with an additional five-year extension available if granted by the IRS.

the plan assets, values may be used for a stated period generally not to exceed the five most recent plan years, including the current year.

### **3. Additional requirements for multiemployer plans in endangered or critical status**

#### **In general**

Additional funding requirements apply to multiemployer defined benefit plans in effect on July 16, 2006, that are in endangered or critical status.<sup>94</sup> In connection with these requirements, a multiemployer plan's actuary is required to certify to the IRS and to the plan sponsor each year whether the plan is in endangered status, critical status, or neither.<sup>95</sup> If a plan is certified to be in endangered or critical status, the plan sponsor must provide notification of the plan's status within 30 days after the date of certification to the participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor. In addition, as discussed further below, the plan sponsor must adopt a funding improvement plan in the case of a multiemployer plan in endangered status and a rehabilitation plan in the case of a multiemployer plan in critical status.<sup>96</sup>

#### **Definitions of endangered and critical status**

##### **Endangered status**

A multiemployer plan is generally in endangered status if the plan is not in critical status and, as of the beginning of the plan year, (1) the plan's funded percentage for the plan year is less than 80 percent, or (2) the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization extensions). A plan's funded percentage is the percentage determined by dividing the value of plan assets by the accrued liability of the plan. A plan that meets the requirements of both (1) and (2) is treated as in seriously endangered status.<sup>97</sup>

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<sup>94</sup> Sec. 432 and ERISA sec. 305. The rules for multiemployer plans in endangered or critical status as originally enacted by PPA were generally scheduled to expire for plan years beginning after December 31, 2014. The rules were amended and made permanent by MPRA.

<sup>95</sup> In the case of a plan that is in a funding improvement or rehabilitation period, as discussed below, the actuary must certify whether or not the plan is making scheduled progress in meeting the requirements of its funding improvement or rehabilitation plan.

<sup>96</sup> Certain operational restrictions, such as limits on increasing benefits, apply while a plan is in endangered or critical status.

<sup>97</sup> A plan is treated as not being in endangered status if the plan was not in critical or endangered status for the immediately preceding plan year and the plan actuary certifies that the plan is projected to no longer be described in (1) or (2) above as of the end of the tenth plan year ending after the plan year to which the certification relates.

### Critical status

A multiemployer plan is generally in critical status for a plan year if as of the beginning of the plan year:

- The funded percentage of the plan is less than 65 percent and the sum of (1) the market value of plan assets, plus (2) the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses);
- (1) The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization extension, or (2) the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization extensions;
- (1) The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, (2) the present value of nonforfeitable benefits of inactive participants is greater than the present value of nonforfeitable benefits of active participants, and (3) the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years, not taking into account amortization extensions; or
- The sum of (1) the market value of plan assets, plus (2) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).<sup>98</sup>

### **Funding improvement plan**

In the case of a multiemployer plan in endangered status, a funding improvement plan must be adopted within 240 days following the deadline for certifying a plan's status.<sup>99</sup> A funding improvement plan is a plan that consists of the actions, including options or a range of options, to be proposed to the bargaining parties, formulated to provide, based on reasonably anticipated experience and reasonable actuarial assumptions, for the attainment by the plan of

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<sup>98</sup> If a plan is not in critical status under one of these standards, but is projected to be in critical status in any of the succeeding five plan years, the plan sponsor may elect to treat the plan as in critical status.

<sup>99</sup> This requirement applies for the initial determination year (that is, the first plan year that the plan is in endangered status). If a plan sponsor fails to adopt a funding improvement plan by the end of the 240-day period after the required certification date, an ERISA penalty of up to \$1,100 a day applies.

certain requirements (referred to as the “applicable benchmarks”). The plan sponsor must update the funding improvement plan annually to reflect the circumstances of the multiemployer plan.

The funding improvement plan must provide that, by end of the funding improvement period, the plan will have a certain required increase in the funded percentage and the plan will not have an accumulated funding deficiency for the last plan year in the funding improvement period, taking into account amortization extensions. In the case of a plan that is not in seriously endangered status, under the applicable benchmarks, the plan’s funded percentage must increase such that the funded percentage as of the close of the funding improvement period equals or exceeds a percentage equal to the sum of (1) the funded percentage at the beginning of the first plan year for which the plan is in endangered status, plus (2) 33 percent of the difference between 100 percent and the percentage in (1). Thus, the difference between 100 percent and the plan’s funded percentage at the beginning of the first plan year for which the plan is in endangered status must be reduced by at least one-third by the end of the funding improvement period.

The funding improvement period is generally the 10-year period beginning on the first day of the first plan year beginning after the earlier of (1) the second anniversary of the date of adoption of the funding improvement plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of endangered status for the initial determination year and covering, as of such date, at least 75 percent of the plan’s active participants. The period ends if the plan is no longer in endangered status or if the plan enters critical status.

In the case of a plan in seriously endangered status that is funded at 70 percent or less, under the applicable benchmarks, the difference between 100 percent and the plan’s funded percentage at the beginning of the first plan year for which the plan is in endangered status must be reduced by at least one-fifth by the end of the funding improvement period. In the case of such a plan, a 15-year funding improvement period is used.

In the case of a seriously endangered plan that is more than 70-percent funded as of the beginning of the initial determination year, the same benchmarks apply for plan years beginning on or before the date on which the last collective bargaining agreements in effect on the date for actuarial certification for the initial determination year and covering at least 75 percent of active employees in the multiemployer plan have expired if the plan actuary certifies within 30 days after certification of endangered status that the plan is not projected to attain the funding percentage increase otherwise required by the provision. Thus, for such plans, the difference between 100 percent and the plan’s funded percentage at the beginning of the period must be reduced by at least one-fifth during the 15-year funding improvement period. For subsequent years for such plans, if the plan actuary certifies that the plan is not able to attain the increase generally required under the provision, the same benchmarks continue to apply.

If, for the first plan year following the close of the funding improvement period, the plan’s actuary certifies that the plan is in endangered status, the year is treated as an initial determination year. Thus, a new funding improvement plan must be adopted within 240 days of the required certification date. In that case, the multiemployer plan may not be amended in a

manner inconsistent with the funding improvement plan in effect for the preceding plan year until a new funding improvement plan is adopted.

In the case of a multiemployer plan in endangered status, but not seriously endangered status, a civil penalty of \$1,100 a day may apply if the plan fails to meet the applicable benchmarks by the end of the funding improvement period. If a multiemployer plan in seriously endangered status fails to meet the applicable benchmarks by the end of the funding improvement period, for excise tax purposes (unless the excise tax is waived), the plan is treated as having a funding deficiency equal to (1) the amount of the contributions necessary to meet the applicable benchmarks and (2) the plan's actual funding deficiency, if any.

### **Rehabilitation plan**

If a plan is in critical status for a plan year, the plan sponsor must adopt a rehabilitation plan within 240 days following the required date for the actuarial certification of critical status.<sup>100</sup> A rehabilitation plan is a plan that consists of actions, including options or a range of options to be proposed to the bargaining parties, formulated, based on reasonable anticipated experience and reasonable actuarial assumptions, to enable the plan to cease to be in critical status by the end of the rehabilitation period and may include reductions in plan expenditures (including plan mergers and consolidations), reductions in future benefits accruals or increases in contributions, if agreed to by the bargaining parties, or any combination of such actions. A rehabilitation plan must provide annual standards (referred to as scheduled progress) for meeting the requirements of the rehabilitation plan. The plan must also include the schedules required to be provided to the bargaining parties, as discussed below. The plan sponsor must update the rehabilitation plan annually to reflect the circumstances of the multiemployer plan.

If the plan sponsor determines that, based on reasonable actuarial assumptions and upon exhaustion of all reasonable measures, the plan cannot reasonably be expected to emerge from critical status by the end of the rehabilitation period, the plan must include reasonable measures to emerge from critical status at a later time or to forestall possible insolvency. In such case, the plan must set forth alternatives considered, explain why the plan is not reasonably expected to emerge from critical status by the end of the rehabilitation period, and specify when, if ever, the plan is expected to emerge from critical status in accordance with the rehabilitation plan.

The rehabilitation period is generally the 10-year period beginning on the first day of the first plan year following the earlier of (1) the second anniversary of the date of adoption of the rehabilitation plan or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of critical status for the initial critical year and covering at least 75 percent of the active participants in the plan. The rehabilitation period ends if the plan emerges from critical status.

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<sup>100</sup> The requirement applies with respect to the initial critical year. If a plan sponsor fails to adopt a rehabilitation plan within 240 days after the date required for certification, an ERISA penalty of \$1,100 a day applies. In addition, upon the failure to timely adopt a rehabilitation plan, an excise tax is imposed on the plan sponsor equal to the greater of (1) the present law excise tax or (2) \$1,100 per day.

If a multiemployer plan fails to make scheduled progress under the rehabilitation plan for three consecutive years or fails to meet the requirements applicable to plans in critical status by the end of the rehabilitation period, for excise tax purposes (unless the excise tax is waived), the plan is treated as having a funding deficiency equal to (1) the amount of the contributions necessary to leave critical status or make scheduled progress or (2) the plan's actual funding deficiency, if any.

### **Excise tax on employers failing to make required contributions**

If a funding improvement or rehabilitation plan requires an employer to make contributions to the multiemployer plan and the employer fails to make the contributions within the time required under the plan, an excise tax (unless waived) applies to the employer in the amount of required contributions the employer failed to make.

### **Information to be provided to bargaining parties**

Within 30 days of the adoption of a funding improvement or rehabilitation plan, the plan sponsor must provide to the bargaining parties schedules showing revised benefit structures, revised contribution structures, or both, which, if adopted, may reasonably be expected to enable the multiemployer plan to meet the applicable requirements under the funding improvement or rehabilitation plan.<sup>101</sup> Certain schedules of contributions and benefits are required to be provided to the bargaining parties and, in each case, a particular schedule must be designated as the default schedule under the funding improvement or rehabilitation plan.<sup>102</sup> The plan sponsor may provide the bargaining parties with additional information as it deems appropriate.

If a collective bargaining agreement providing for plan contributions that was in effect at the time the plan entered endangered or critical status expires, and after receiving one or more schedules from the plan sponsor, the bargaining parties fail to adopt a contribution schedule consistent with the funding improvement or rehabilitation plan, the plan sponsor must implement the default schedule 180 days after the date on which the collective bargaining agreement expires. If a subsequent collective bargaining agreement expires and the bargaining parties fail to adopt a contribution schedule consistent with the updated funding improvement or rehabilitation plan, the plan sponsor must implement the schedule applicable under the expired collective bargaining agreement (whether adopted by the parties or implemented by the plan sponsor), as updated and in effect on the date the collective bargaining agreement expires, 180 days after the date on which the collective bargaining agreement expires.

### **Additional rules for multiemployer plans in critical status**

In the case of a multiemployer plan in critical status, if a rehabilitation plan is adopted and complied with, employers are not liable for contributions otherwise required under the

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<sup>101</sup> The plan sponsor must annually update any schedule of contribution rates under a funding improvement or rehabilitation plan to reflect the experience of the multiemployer plan.

<sup>102</sup> A default schedule under a rehabilitation plan that includes reductions in future benefit accruals must not reduce the rate of benefit accruals below a specified minimum level.

general funding rules. In addition, the excise tax for failure to meet the funding requirements, that is, in the case of an accumulated funding deficiency, does not apply.

Certain plan contributions (“surcharges”), in addition to the contributions required under a collective bargaining agreement, apply to employers otherwise obligated to make a contribution in the first plan year for which the plan is in critical status. For that year, the surcharge is five percent of the contribution otherwise required to be made under the applicable collective bargaining agreement. The surcharge is 10 percent of contributions otherwise required in the case of succeeding plan years in which the plan is in critical status. The surcharge applies 30 days after the employer is notified by the plan sponsor that the plan is in critical status and the surcharge is in effect. The surcharges are due and payable on the same schedule as the contributions on which the surcharges are based. Failure to make the surcharge payment is treated as a delinquent contribution under a collective bargaining agreement. The surcharge is not required with respect to employees covered by a collective bargaining agreement (or other agreement pursuant to which the employer contributes), beginning on the effective date of a collective bargaining agreement (or other agreement) that includes terms consistent with a schedule provided by the plan sponsor. Surcharges may not be the basis for any benefit accrual under the plan, and surcharges are generally disregarded in determining an employer’s withdrawal liability.

#### **4. Withdrawal liability**

An employer that withdraws from a multiemployer plan in a complete or partial withdrawal is generally liable to the plan in the amount determined to be the employer’s withdrawal liability.<sup>103</sup> In general, a “complete withdrawal” means the employer has permanently ceased operations under the plan or has permanently ceased to have an obligation to contribute. A “partial withdrawal” generally occurs if, on the last day of a plan year, there is a 70-percent contribution decline for such plan year or there is a partial cessation of the employer’s contribution obligation.

When an employer withdraws from a multiemployer plan, the plan sponsor is required to determine the amount of the employer’s withdrawal liability, notify the employer of the amount of the withdrawal liability, and collect the amount of the withdrawal liability from the employer. In order to determine an employer’s withdrawal liability, a portion of the plan’s unfunded vested benefits is first allocated to the employer, generally in proportion to the employer’s share of plan contributions for a previous period.<sup>104</sup> The amount of unfunded vested benefits allocable to the employer is then subject to various reductions and adjustments. An employer’s withdrawal liability is generally payable, with interest, in level annual installments. However, the amount of the annual installments is limited, based on the amount of the employer’s previous contributions to the plan, and the period over which installments are paid is limited to 20 years. An employer’s withdrawal is the amount determined after application of these limits. In addition,

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<sup>103</sup> ERISA secs. 4201-4225.

<sup>104</sup> Under 29 C.F.R. sec. 4211.2, for this purpose, unfunded vested benefits is the amount by which the value of vested benefits under the plan exceeds the value of plan assets.

the plan sponsor and the employer may agree to settle an employer's withdrawal liability obligation for a different amount.

As discussed in Part I.C.1, if a multiemployer plan is in critical status, payments in excess of a single life annuity (plus any social security supplement, if applicable) may not be made and reductions in adjustable benefits are permitted. If a plan is in critical and declining status, benefit suspensions are permitted, including with respect to participants and beneficiaries in pay status. The elimination of any prohibited forms of distribution and reductions in adjustable benefits are disregarded in determining a plan's unfunded vested benefits for purposes of determining an employer's withdrawal liability. In addition, suspensions of benefits made under a multiemployer plan in critical and declining status are disregarded in determining the plan's unfunded vested benefits for purposes of determining an employer's withdrawal liability unless the withdrawal occurs more than 10 years after the effective date of the benefit suspension.

## E. Multiemployer Plan Program of the PBGC

### 1. In general

The minimum funding requirements permit defined benefit plan benefits to be funded over a period of time. Thus, plan assets as of any time may not be sufficient to provide all benefits earned by employees under the plan. In order to protect plan participants and beneficiaries from losing retirement benefits in such circumstances, the PBGC, a corporation within DOL, was created under ERISA to provide an insurance program for benefits under most defined benefit plans maintained by private employers.<sup>105</sup>

ERISA provides that the PBGC is administered by a director, who is appointed by the President of the United States by and with the advice and consent of the Senate. The director must act in accordance with policies established by the board of directors of the PBGC. The composition of the board of directors is specified under ERISA as the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Commerce. The Secretary of Labor is the chairman of the board of directors.

The PBGC is financed through the payment of premiums by covered defined benefit plans, assets from terminated single-employer defined benefit plans trusted by the PBGC, and investment income on PBGC assets. The PBGC insures pension benefits under separate programs, one for single-employer defined benefit plans and the other for multiemployer defined benefit plans.<sup>106</sup> Assets held by the PBGC are divided among several funds, with specified purposes for each fund, and amounts in a particular fund are prohibited from being used for other purposes.<sup>107</sup>

Under ERISA, the PBGC board of directors selects a Participant and Plan Sponsor Advocate, who generally acts as a liaison between the PBGC, defined benefit plan sponsors, and participants in defined benefit plans trusted by the PBGC.<sup>108</sup>

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<sup>105</sup> ERISA secs. 4001-4071. Governmental and church plans are generally not covered by the PBGC insurance programs.

<sup>106</sup> For a description of the PBGC single-employer plan program, see Joint Committee on Taxation, *Present Law and Background Relating to Qualified Defined Benefit Plans* (JCX-99-14), September 15, 2014, Part I.E.2. Multiple-employer defined benefit plans are covered by the PBGC insurance program for single-employer plans. PBGC insurance coverage does not apply to nonqualified deferred compensation plans or to certain private qualified defined benefit plans maintained exclusively for substantial owners of the employer sponsoring the plan or maintained by a professional service employer that at no time has more than 25 active participants.

<sup>107</sup> ERISA sec. 4005.

<sup>108</sup> ERISA sec. 4004.

## **2. Multiemployer Plan Program**

### **Premiums**

In the case of a multiemployer plan, flat-rate premiums apply at a rate of \$28 per participant for 2018 with indexing thereafter.

### **Guarantee**

In the case of multiemployer plans, the PBGC insures plan insolvency, rather than plan termination. Accordingly, a multiemployer plan need not be terminated to qualify for PBGC financial assistance, but must be found to be insolvent. A plan is insolvent when its available resources are not sufficient to pay the plan benefits for the plan year in question, or when the sponsor of a plan in critical status reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources will not be sufficient to pay benefits that come due in the next plan year. If it appears that available resources will not support the payment of benefits at the guaranteed level, the PBGC will provide the additional resources needed as a loan, referred to as financial assistance. The PBGC may provide loans to the plan for multiple years. If the plan recovers from insolvency, it must begin repaying loans on reasonable terms in accordance with regulations.

The PBGC benefit guarantee level for multiemployer plans is the sum of 100 percent of the first \$11 of vested monthly benefits and 75 percent of the next \$33 of vested monthly benefits, multiplied by the participant's number of years of service. Thus, the guarantee level for a particular participant depends on the participant's years of service. For example, if a participant has 20 years of service under a multiemployer plan, the maximum monthly benefit for that participant that is covered by the guarantee is \$35.75 per month  $[(100\% \times \$11) + (75\% \times \$33)] \times 20 = \$715$ , or a yearly benefit of \$8,580  $(\$715 \times 12)$ .

## **3. Multiemployer plan mergers and partitions**

### **In general**

In addition to providing financial assistance to an insolvent multiemployer plan, the PBGC has authority with respect to mergers and assets transfers between multiemployer plans and partitions of multiemployer plans.<sup>109</sup>

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<sup>109</sup> The PBGC rules relating to mergers and transfers and partitions were amended by sections 121 and 122 of MPRA.

## **Plan mergers and transfers**<sup>110</sup>

A plan sponsor generally may not cause a multiemployer plan to merge with one or more other multiemployer plans, or engage in a transfer of assets and liabilities to or from another multiemployer plan, unless the following requirements are met:

- the plan sponsor notifies the PBGC of the merger or transfer at least 120 days before the effective date of the merger or transfer,
- no participant's or beneficiary's accrued benefit will be lower immediately after the effective date of the merger or transfer than immediately before the effective date,
- the benefits of participants and beneficiaries are not reasonably expected to be subject to suspension as a result of plan insolvency, and
- an actuarial valuation of the assets and liabilities of each of the affected plans has been performed in accordance with PBGC regulations.

In connection with a possible merger of multiemployer plans, when requested by the plan sponsors of the relevant plans, the PBGC may take actions as it deems appropriate to promote and facilitate the merger of the plans. Before taking action, the PBGC must determine, after consultation with the Participant and Plan Sponsor Advocate that the merger is in the interests of the participants and beneficiaries of at least one of the plans and is not reasonably expected to be adverse to the overall interests of the participants and beneficiaries of any of the plans. Actions taken by the PBGC may include training, technical assistance, mediation, communication with stakeholders, and support with related requests to other government agencies.

In order to facilitate a merger that the PBGC determines is necessary to enable one or more of the plans involved to avoid or postpone insolvency, the PBGC may provide financial assistance to the merged plan if (1) one or more of the multiemployer plans participating in the merger is in critical and declining status, (2) the PBGC reasonably expects that the financial assistance will reduce the PBGC's expected long-term loss with respect to the plans involved and is necessary for the merged plan to become or remain solvent, (3) the PBGC certifies that its ability to meet existing financial assistance obligations to other plans will not be impaired by providing the financial assistance, and (4) the financial assistance is paid exclusively from the PBGC fund for basic benefits guaranteed for multiemployer plans.

Not later than 14 days after the provision of financial assistance, the PBGC must provide notice thereof to the Committees of the House of Representatives ("House Committees") on Education and the Workforce and on Ways and Means and the Committees of the Senate ("Senate Committees") on Finance and on Health, Education, Labor, and Pensions.

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<sup>110</sup> ERISA sec. 4231; 29 C.F.R. secs. 4231.1-4231.10.

## **Partitions of eligible multiemployer plans**<sup>111</sup>

On application by the plan sponsor of an eligible multiemployer plan for a partition of the plan, the PBGC may order a partition of the plan. Not later than 30 days after submitting an application to the PBGC for partition of a plan, the plan sponsor must notify the participants and beneficiaries of the application, in the form and manner prescribed by PBGC regulations.

For purposes of the provision, a multiemployer plan is an eligible multiemployer plan if--

- the plan is in critical and declining status,
- the PBGC determines, after consultation with the Participant and Plan Sponsor Advocate, that the plan sponsor has taken (or is taking concurrently with an application for partition) all reasonable measures to avoid insolvency, including maximum benefit suspensions permitted in the case of a critical and declining plan, if applicable,
- the PBGC reasonably expects that a partition of the plan will reduce the PBGC's expected long-term loss with respect to the plan and is necessary for the plan to remain solvent,
- the PBGC certifies to Congress that the PBGC's ability to meet existing financial assistance obligations to other plans (including any liabilities associated with multiemployer plans that are insolvent or that are projected to become insolvent within 10 years) will not be impaired by the partition, and
- the cost to the PBGC arising from the proposed partition is paid exclusively from the PBGC fund for basic benefits guaranteed for multiemployer plans.

The PBGC must make a determination regarding a partition application not later than 270 days after the application is filed (or, if later, the date the application is completed) in accordance with PBGC regulations. Not later than 14 days after a partition order, the PBGC must provide notice thereof to the House Committees on Education and the Workforce and on Ways and Means and the Senate Committees on Finance and on Health, Education, Labor, and Pensions, as well as to any affected participants or beneficiaries.

The plan sponsor and the plan administrator of the eligible multiemployer plan (the "original" plan) before the partition are the plan sponsor and plan administrator of the plan created by the partition order (the "new" plan). For purposes of determining benefits eligible for guarantee by the PBGC, the new plan is a successor plan with respect to the original plan.

The PBGC's partition order is to provide for a transfer to the new plan the minimum amount of the original plan's liabilities necessary for the original plan to remain solvent. The provision does not provide for the transfer to the new plan of any assets of the original plan.

The liabilities transferred to the new plan are liabilities attributable to benefits of specific participants and beneficiaries (or a specific group or groups of participants and beneficiaries) as

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<sup>111</sup> ERISA sec. 4233; 29 C.F.R. secs. 4233.1-4233.17.

requested by the plan sponsor of the original plan and approved by the PBGC, up to the PBGC guarantee level applicable to each participant or beneficiary. Thus, benefits for such participants and beneficiaries up to the guarantee level will be paid by the new plan. For each month after the effective date of the partition that such a participant or beneficiary is in pay status, the original plan will pay a monthly benefit to the participant or beneficiary in the amount by which (1) the monthly benefit that would be paid to the participant or beneficiary under the terms of the original plan if the partition had not occurred (taking into account any benefit suspensions and any plan amendments after the effective date of the partition) exceeds (2) the amount of the participant's or beneficiary's benefit up to the PBGC guarantee level.

During the 10-year period following the effective date of the partition, the original plan must pay the PBGC premiums due for each year with respect to participants whose benefits were transferred to the new plan. The original plan must pay an additional amount to the PBGC if it provides a benefit improvement (as defined under the rules for plans in critical and declining status) that takes effect after the effective date of the partition. Specifically, for each year during the 10-year period following the effective date of the partition, the original plan must pay the PBGC an annual amount equal to the lesser of (1) the total value of the increase in benefit payments for the year that is attributable to the benefit improvement, or (2) the total benefit payments from the new plan for the year. This payment must be made to the PBGC at the time of, and in addition to, any other PBGC premium due from the original plan.

If an employer withdraws from the original plan within ten years after the date of the partition order, the employer's withdrawal liability will be determined by reference to both the original plan and the new plan. If the withdrawal occurs more than ten years after the date of the partition order, withdrawal liability will be determined only by reference to the original plan and not with respect to the new plan.

**F. Data on Funded Status of Multiemployer Plans  
and Status of PBGC Programs**

Below is information about the funded status of multiemployer defined benefit plans insured by the PBGC. Information about PBGC-insured multiemployer plans and their funded status is taken from PBGC Pension Insurance Data Tables 2015 and 2016.<sup>112</sup>

Table 1 presents data on the total number of multiemployer plans that are covered by the PBGC and the total number of insured participants in these plans.

**Table 1.—Number of PBGC-Insured Multiemployer Plans  
and Participants as of 2016**

Number of Plans	Number of Participants
1,375	10,465,000

Source: PBGC premium filings.

Note: Figures are estimates from PBGC internal calculations.

Tables 2, 3, and 4 contain information on the estimated levels of aggregate underfunding and overfunding in multiemployer plans as well as total assets and liabilities for all multiemployer plans; all multiemployer plans that are underfunded; and all multiemployer plans that are overfunded, respectively.

Table 2 shows a sharp increase in aggregate liabilities between 2011 and 2012, along with a drop in the aggregate funding ratio through 2013, an increase in aggregate underfunding of underfunded plans through 2013, and a decrease in aggregate overfunding in overfunded plans through 2013. There is a sharp reversal in these trends in 2014, though it is difficult to draw conclusions about longer term trends based on a single year.

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<sup>112</sup> Available at <https://www.pbgc.gov/sites/default/files/2015-pension-data-tables.pdf> and [https://www.pbgc.gov/sites/default/files/2016\\_pension\\_data\\_tables\\_-\\_release\\_1.pdf](https://www.pbgc.gov/sites/default/files/2016_pension_data_tables_-_release_1.pdf). Notes in the relevant PBGC source tables describe the interest and mortality assumptions used in determining vested liabilities.

**Table 2.—Estimated Aggregate Funding of Multiemployer Plans,  
2009-2014**

<b>Year</b>	<b>Assets (millions)</b>	<b>Liabilities (millions)</b>	<b>Aggregate Funding Ratio</b>	<b>Aggregate Underfunding in Underfunded Plans (millions)</b>	<b>Aggregate Overfunding in Overfunded Plans (millions)</b>
2009	\$326,940	\$672,513	49%	\$345,788	\$215
2010	\$366,333	\$756,999	48%	\$391,027	\$360
2011	\$398,263	\$798,963	50%	\$401,080	\$380
2012	\$392,245	\$964,299	41%	\$572,228	\$174
2013	\$422,942	\$1,033,758	41%	\$611,115	\$299
2014	\$467,985	\$962,902	49%	\$495,712	\$795

Source: Form 5500 filings.

**Table 3.—Estimated Aggregate Funding for 2014 of Underfunded  
Multiemployer Plans**

<b>Assets (millions)</b>	<b>Liabilities (millions)</b>	<b>Aggregate Funding Ratio</b>	<b>Aggregate Underfunding in Underfunded Plans (millions)</b>
\$462,543	\$958,255	48%	\$495,712

Source: Form 5500 filings.

**Table 4.—Estimated Aggregate Funding for 2014 of Overfunded  
Multiemployer Plans**

<b>Assets (millions)</b>	<b>Liabilities (millions)</b>	<b>Aggregate Funding Ratio</b>	<b>Aggregate Overfunding in Overfunded Plans (millions)</b>
\$5,442	\$4,647	117%	\$795

Source: Form 5500 filings.

Note: Table M-13 of PBGC Pension Insurance Data Tables 2015 shows 26 multiemployer plans were overfunded for 2014 (1.8 percent of all plans for 2014), covering 0.6 percent of all participants and having 0.5 percent of total plan liabilities.

In 2014, there were a total of 1,345 underfunded plans, constituting 94.4 percent of all multiemployer plans. The 50 plans with the highest levels of underfunding accounted for 54.96 percent of total underfunding for all multiemployer plans. Table 5 displays data on the distribution of underfunded amounts across plans. The table shows that in 2014, the ten plans with the highest levels of underfunding together account for 27.51 percent of aggregate levels of underfunding and approximately 2.7 million participants. The next 40 plans with highest underfunding account for another 27.45 percent of aggregate levels of underfunding and approximately 2.8 million participants.

**Table 5.—Estimated Concentration of Underfunding  
in Multiemployer Plans, 2014**

<b>Plans</b>	<b>Underfunding Amount (millions)</b>	<b>Percentage of Total Underfunding</b>	<b>Total Participants<sup>1</sup></b>
All plans	\$495,712	100%	Approximately 10.4 million
10 plans with highest underfunding	\$136,350	27.51%	Approximately 2.7 million
Next 40 plans with highest underfunding	\$136,095	27.45%	Approximately 2.8 million
All other plans	\$223,267	45.04%	Approximately 4.9 million

Source: Form 5500 filings.

<sup>1</sup> Participant counts are JCT internal calculations of 5500 data.

Table 6 presents data on the financial condition of the PBGC's multiemployer program. As of September 30, 2017, total liabilities exceeded total assets by approximately \$65.1 billion.

**Table 6.—PBGC Financial Condition as of September 30, 2017,  
Multiemployer Plan Program<sup>1</sup>**

<b>Item</b>	<b>Amount (millions)</b>
Total Assets	\$2,262
Total Liabilities	\$67,314
Net position	(\$65,052)

Source: PBGC Annual Report, 2017.

<sup>1</sup> Total liabilities under the multiemployer program include the present value of nonrecoverable future financial assistance to be provided to multiemployer plans by PBGC.