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February 21, 2017

Regulatory Affairs Group  
Office of the General Counsel  
Pension Benefit Guaranty Corporation (PBGC)  
1200 K Street NW  
Washington, DC 20005-4026

[Submitted via [www.regulations.gov](http://www.regulations.gov)]

**RE: Response to Request for Information on Alternative Two-Pool Withdrawal Liability Methods**

To Whom It May Concern:

The Multiemployer Pension Plans Subcommittee of the American Academy of Actuaries<sup>1</sup> respectfully submits the following comments in response to the request for information (RFI) regarding two-pool alternative withdrawal liability methods issued by the PBGC.

The new alternative two-pool withdrawal liability methods have the potential to provide significant benefits to multiemployer plans, but they also pose certain risks and raise many complex questions. In addition to the comments contained in this letter, the subcommittee is available for an in-person discussion with representatives of the PBGC to discuss the issues and implications of alternative withdrawal liability methods in more depth. If the PBGC is interested in such a discussion, we look forward to scheduling a meeting after you have had a chance to review the information gathered from the request for information.

**Introduction**

Before comparing the benefits and risks directly associated with two-pool withdrawal liability methods, it is helpful to review the risks already present in the multiemployer system. Employers contributing to plans bear the risk that both the required contribution rates and exposure to withdrawal liability will increase in the future. Participants bear the risk of benefit reductions, either from trustee actions such as critical status adjustable benefit reductions and critical and declining status benefit suspensions, or from PBGC-mandated benefit reductions at the point of plan insolvency. The PBGC bears the risk associated with future financial assistance payments in the event the plan exhausts its assets in the future—along

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<sup>1</sup> The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

with the risk that such payments are projected to overwhelm the financial resources available to the PBGC within the next 10 years.

The plan trustees have an ongoing duty to act in the best interest of plan participants, which requires balancing various risks and objectives. In order to reduce the risks for participants, trustees may seek large contribution increases and might take aggressive positions regarding the assessment and collection of withdrawal liability when plan sponsors are unwilling to accede to those demands. However, plan trustees could also consider the impact that these actions will have on participation in the plan, since both employers and employees will be reluctant to contribute to plans if they believe the costs and risks are too great. While two-pool withdrawal liability methods represent a potential new tool for plans to use, the decisions surrounding whether to adopt such a method, and what provisions to apply, are not dissimilar from decisions that multiemployer plan trustees are already required to make.

### **Potential Benefits of Two-Pool Methods**

The most significant potential benefits of two-pool withdrawal liability methods are the ability to help plans retain contributing employers that might otherwise withdraw and attract new employers that otherwise would be unwilling to enter. Maintaining a healthy base of contributing employers can prevent plans from becoming distressed, and can help plans in moderate distress to recover.

Another very important potential benefit of these methods, especially for a plan with funding concerns, is increased cash flow to the plan over the long or short term. An employer that pays its withdrawal liability in the “old pool” and then remains as a continuing contributor in the “new pool” for many years may add more to the financial health of the plan than it would have had it either withdrawn fully or remained in the old pool. For plans already in serious distress, the short-term increase in revenue from plans moving into the new pool could either forestall the projected failure of the plan, or, in conjunction with other tools such as benefit suspensions for critical and declining plans, could provide the key to avoiding plan insolvency.

### **Employer Retention and Recruitment**

Whether a multiemployer plan is well-funded or poorly funded, its long-term viability is affected by the strength of its base of contributing employers. In well-funded plans, a healthy contribution base—that is, a relatively large population of active participants in an industry with stable employers—provides resilience against adverse experience. In poorly funded plans, this trait is often vital to recovery. All other things being equal, a plan with a large number of financially strong contributing employers provides greater benefit security to participants and represents a lower risk of loss to the PBGC. There is evidence for this relationship among multiemployer plans today, where the strength of the industry and stability of the population of contributing employers is the most significant factor that separates “green zone” plans from critical and declining plans.

Many plans in critical status have experienced increased positive cash flow in recent years due to the bargained contribution increases required under rehabilitation plans. Simultaneously, some plans have experienced the voluntary withdrawal and/or bankruptcy of contributing employers, which has offset the projected improvement expected from contribution increases. In addition, while the withdrawal liability changes in the Multiemployer Pension Reform Act of 2014 (“MPRA”) should have helped to reduce the anxiety associated with the impact of future required contribution increases on withdrawal liability

exposure, considerable uncertainty and wariness remain. Employer withdrawals continue to be a risk even well-funded plans face.

Financially stable employers are often frustrated as the bankruptcy of other employers transfers cost and liability to them in the form of higher contribution requirements and increased withdrawal liability exposure. This environment encourages healthy employers to withdraw before additional financial responsibility shifts to them, which in turn places greater financial stress on the plan. Employers may also seek to withdraw from healthy plans that have not experienced a significant number of withdrawals in the past, out of fear of what could occur in the future. Over time, these forces may lead to an underfunded plan that consists primarily of employers that could not afford the price of withdrawal. The two-pool method offers an opportunity for healthy employers to remain in a plan while insulating themselves from other, less financially stable employers.

Plans using a two-pool withdrawal liability approach may more easily attract new employers even when a plan has significant unfunded vested benefits, as many of the same considerations that apply to existing employers also apply to new employers. Historically, a hurdle to potential new employers becoming contributors to a multiemployer fund is a concern on the part of the new employer that it will be taking on a portion of the plan's legacy withdrawal liability. The extent to which this concern is true depends in part on the withdrawal liability allocation method in use, but evaluating this issue in depth is in the opinion of the members of the subcommittee often beyond the ability of prospective employers. The new alternative two-pool methods offer a transparent approach to limiting the extent to which a new employer is exposed to legacy liabilities.

#### Improved Cash Flows Over the Long and Short Term

When an existing employer moves to the new pool, it is obligated to pay a withdrawal liability assessment and contribute to the plan as a participating employer. In return, the employer receives a measure of protection from future cost and liability increases and may also receive favorable withdrawal liability settlement or contributing employer terms. If the plan remains in operation for many years in the future with the employer participating in the new pool, there is a potential that the plan will receive substantially more income in excess of benefit accruals from the employer than it would have in the absence of the two-pool method. Even if the terms of the withdrawal liability assessment are more favorable than the terms available to employers that actually withdraw from the plan, and the contribution and benefit schedules are similarly favorable, the fact that the employer is making payments to the plan under both arrangements creates the possibility that the plan is better off under this approach.

For plans that are already highly distressed and are likely to exhaust their assets, increasing short-term cash flow is essential to delaying the benefit cuts that will occur when the plan fails. As employers move into the new pool, the corresponding withdrawal liability assessments create additional short-term cash flow that has the potential to delay those benefit cuts. In some circumstances, the increased cash flow in excess of benefit accruals might be sufficiently beneficial to allow a critical and declining status plan to develop a viable benefit suspension approach or may lessen the severity of such suspensions.

#### **Potential Risk of Two-Pool Methods**

The risks attendant to a two-pool withdrawal liability arrangement fall primarily into two categories:

- Risks to plan participants and the PBGC

- Risks to employers

### Risks to Plan Participants and the PBGC

The primary risk to participants is that the two-pool arrangement will result in the plan being less well-funded over time than it would have been if some other course of action had been followed within a typical arrangement. While trustees may adopt the two-pool approach with the intent that it will strengthen the plan, many future events will determine how the approach affects the plan in practice, and it is impossible to know in advance what the actual impact will be.

The risk to participants is inherent in the two-pool method. The primary objective of employers that move into the new pool is to obtain insulation from increases in their withdrawal liability exposure. Insulating employers from withdrawal liability increases lessens the ability of the plan to collect withdrawal liability in the future, which has the potential to adversely affect participant benefits if the funding level of the plan deteriorates in the future. In the event that an employer ultimately withdraws from the plan after the funding level weakens, the two-pool method may result in the plan collecting less withdrawal liability than it would have under the traditional approach. This situation can occur when the employer moving into the new pool settles its assessment under the same terms that apply in traditional withdrawals, but the risk is exacerbated if more favorable settlement terms apply in conjunction with the two-pool method.

Additionally, in the event that new-pool employers do not withdraw, favorable contribution rate and benefit accrual provisions that might be offered to encourage employers to move into the new pool could potentially result in a less well-funded plan than would otherwise have been the case. A related risk applies to old-pool participants, because they may receive lower benefit accruals or be subject to greater benefit reductions than might otherwise be necessary as a result of new-pool commitments with respect to future contribution levels and new-pool benefit levels.

The risks to participants can be mitigated through the prudent design of the two-pool arrangement and through taking care when negotiating special arrangements with individual employers. Alternatively, these risks may be exacerbated if there is pressure from one or more significant contributing employers on the trustees to negotiate overly favorable deals for employers that move from the old pool to the new pool.

While these risks primarily affect plan participants, they also impact the PBGC in much the same way. If the adoption of an alternative two-pool withdrawal liability method is unsuccessful in its goal of improving funding levels and actually proves to be detrimental to the health of a plan, the plan is more likely to become insolvent, triggering both benefit reductions for participants and the payment of financial assistance by the PBGC. There is an additional risk faced by the PBGC it might be subject to criticism if it permits the adoption of alternative two-pool methods that ultimately have adverse impacts on one or more plans.

### Risks to Employers

The risks to new pool employers are primarily the result of possible uncertainty regarding certain aspects of the two-pool arrangements, particularly as it relates to the extent to which the pools receive separate treatment and in regard to the extent to which a two-pool arrangement can include favorable provisions that apply in the event of a future mass withdrawal. A lack of definitive statutory or regulatory guidance

increases the probability that future regulatory changes or litigation may produce results that were not anticipated by the various affected parties.

An additional risk to employers in the new pool is that the two-pool arrangement may ultimately collapse and that they may become responsible for old-pool liability even if they never participated in the old pool or if they have settled their old-pool liability through a withdrawal / re-entry provision. This might happen if all employers in the old pool withdraw or if the employer is included in a mass withdrawal.

Compounding this risk is the fact that in some instances there may be a misunderstanding between the employer and the plan regarding the extent to which employers in the new pool are protected from liabilities in the old pool.

When an employer shields itself from risk by moving into the new pool, that risk is effectively shifted onto the employers that remain in the old pool. As a result, in the event that less-than-expected investment returns or other adverse experience occurs in the future, it may place a greater burden on old-pool employers than would have occurred in the absence of the two-pool method. This could occur because the settlement amount paid by the employer moving into the new pool is insufficient to fund the liability allocated to that employer on a market (or risk-free) settlement basis,<sup>2</sup> and because the plan invests the proceeds from that settlement in risk-bearing securities.

### **Issues Related to Settlement Agreements**

As noted in the RFI, the PBGC has observed that some plans that have sought and received approval of two-pool alternative withdrawal liability rules have made special arrangements with employers to settle their withdrawal liability in conjunction with the transition from the old pool to the new pool. These settlement agreements are separate from the plan's withdrawal liability methodology, and the terms of the agreement are negotiated between the trustees and the transitioning employer.

Some plans have offered favorable settlement terms to transitioning employers, such as discounts and modified payment schedules, as a way to encourage employers to transition from the old pool to the new pool. In these cases, the plan trustees should have determined that absent these favorable terms, the employer would not decide to transition. More importantly, the trustees would have also determined that the transitions will have a positive net effect on plan funding and solvency, after taking into account any discounts offered to the employer. In evaluating the impact of transitions to the new pool on plan funding and solvency, trustees need to consider not only the cash flows expected from the new-pool employers, but also the ability of old-pool employers to bear the increased risk that is shifted to them.

In a traditional employer withdrawal situation, it is common for the plan trustees to negotiate a withdrawal liability settlement with the employer that contains certain discounts. For example, if the statutory payment schedule is limited by the 20-year cap, the plan trustees may negotiate a lump sum payment based on the present value of the 20 years of payments rather than the gross allocated liability amount. Additionally, the plan trustees may accept a discounted lump sum settlement in lieu of future payments, if there are concerns about the employer's long-term viability, or if the discounted settlement would be beneficial to the plan's overall projected solvency. Such withdrawal liability settlements, in our

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<sup>2</sup> There are many considerations when selecting appropriate withdrawal liability assumptions and settlement terms. While the use of risk-free or current "market settlement" rates can help inform these decisions, they do not necessarily represent an appropriate calculation basis for every plan.

experience, are typically handled on a case-by-case basis, taking into account the specific situation of each withdrawing employer.

If the plan has a two-pool withdrawal liability method, however, and several employers are seeking to transition from the old pool to the new pool, it may be more challenging for plan trustees to structure settlements specific to each employer. In other words, a discount offered to one transitioning employer may be demanded by other employers. For that reason, it is incumbent upon the plan trustees to carefully evaluate the risks associated with any withdrawal liability discounts or other terms favorable to the employer in the settlement agreements. Offering a discounted settlement to several transitioning employers has a potentially larger impact than offering a discount to one withdrawing employer.

Another major consideration for the trustees is that any withdrawal liability discounts included in settlement agreements are reallocated to the remaining old-pool employers. Many employers that remain in the old pool may do so because they cannot afford to pay the withdrawal liability assessment that would be required to transition to the new pool. Plan trustees must consider the risk that any withdrawal liability reallocated to these employers will not be paid if they ultimately withdraw. Even if they are able to pay, in many cases these employers are already affected by the 20-year payment cap, so the reallocation will not affect their net withdrawal liability obligation.

### **Issues Related to New Employer Participation Provisions**

When an existing employer moves into the new pool, it makes one or more withdrawal liability payments to the plan, while also remaining as a contributing employer in the plan. As a contributing employer in the new pool, it may be subject to the same contribution rate standards and benefit accrual provisions as employers that remain in the old pool, or different schedules may apply.

The bargained contribution rate under which employers contribute to a plan generally represents both (a) the cost of paying down unfunded liabilities and (b) the cost of ongoing benefit accruals. In most circumstances, a withdrawal liability assessment represents a final settlement of an employer's obligation to a plan for the funding of past benefit accruals.

If the obligation to fund past benefits is considered to be settled, it may be reasonable to conclude that going forward the contribution rate for employers in the new pool needs to only be sufficient to fund benefits earned after the transition to the new pool. In effect, these employers have been deemed to satisfy their obligation to fund past benefits, and therefore their contribution rate only needs to cover benefits earned after the settlement. This perspective provides a basis for permitting employers in the new pool to contribute to the plan at lower rates than employers in the old pool, or alternatively to provide the employees of new-pool employers with more generous benefit provisions.

The applicable legal and regulatory provisions generally treat a withdrawal liability assessment as a final settlement of an employer's funding obligation related to accrued benefits. There are, however, several factors that may cause this treatment to be inconsistent with actuarial principles. These factors provide a basis for concluding that the contribution rate for employers in the new pool should continue to include a payment toward benefits earned prior to the transfer to the new pool, though potentially at a different rate than is paid by employers that remain in the old pool:

- After an employer pays its assessment and moves to the new pool, the funding risk associated with the accrued benefits earned by its employee is shifted to the employers that remain in the old

pool. The amount of the assessment may not reflect the value of this risk transfer.

- The withdrawal liability payment schedule under ERISA section 4219 may effectively cap an assessment to less than the calculated amount of liability allocated to the withdrawn employer.
- The trustees of the plan may accept a settlement arrangement that has a present value below the statutory payment schedule.
- If the withdrawal liability settlement includes future payments, there may be a risk that those payments will ultimately be uncollectible.

Another way to consider this issue is to estimate how much it would cost for the plan to settle the employer's share of the vested accrued benefits, including its share of "orphan liability," by purchasing annuities from an insurer.<sup>3</sup> If an employer were to make such a single-sum payment, none of the factors listed above would apply, and it would be reasonable for that employer to expect that its future contributions to the plan are only calibrated to be able to support benefits earned after the transition.

To the extent that the present value of the actual assessment associated with the transition to the new pool is less than this hypothetical settlement basis, it is appropriate for the employer to continue to make future contribution payments toward the funding of accrued benefits. Looking at it in this way suggests that it makes sense for employers in the new pool to have more favorable contribution and benefit schedules than employers in the old pool, but not so favorable that they are only responsible for benefits earned after the transition. This situation is especially true in cases where the impact of the payment schedule and other factors causes the present value of the assessment to be less than the liability allocated to the employer measured on an expected return basis.

While it is helpful to look at this question from a theoretical perspective, it is equally important to consider the practical issues. Hypothetically speaking, an employer that is considering paying a withdrawal liability assessment and moving into the new pool may not be concerned with whether its contribution rate as a new-pool employer is actuarially fair in light of the amount of its withdrawal liability assessment. It will generally compare this option to the other possible courses of action and select the one that is most favorable to it. Similarly, a plan that is considering the adoption of a two-pool approach will only do so if it concludes that doing so will improve its financial condition over the status quo.

In some cases, an employer may conclude that it is in its best interest to pay the assessment required to move into the new pool even if the future contribution rate for new-pool employers is the same as the rate for old-pool employers. Some factors that could lead employers to reach this conclusion are a high perceived risk that the potential withdrawal liability assessment will go up in the future, a current contribution rate that is not causing financial stress, or significant collective bargaining challenges to withdrawing from the plan. Conversely, if the opposite of these factors are present, an employer might be

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<sup>3</sup> It may be appropriate for this estimate to also include a reserve for future orphan liabilities and a risk charge for potential investment losses on the plan's asset portfolio.

unwilling to move into the new pool despite the fact that doing so would result in dramatically lower contribution rates going forward.

The plan is faced with a similar decision to the employer that is considering moving to the new pool. For example, if the collective bargaining situation is such that employers can withdraw from the plan relatively easily, then it may be necessary for the plan to offer employers in the new pool a large discount on their future contribution rate in order to provide them with an incentive to remain in the plan at all. In this situation, the plan might be better off allowing such an employer to move into the new pool with a substantially reduced contribution rate, provided the rate remains above the level necessary to fund future benefit accruals and expenses, because the alternative is that the employer will withdraw and pay zero future contributions.

### **Balancing Objectives and Role of the PBGC**

Multiemployer plan trustees face a difficult challenge as they attempt to protect the best interests of plan participants. If the plan places too many financial demands on the contributing employers, they may choose to exit the plan—or remain, but cease to be profitable and ultimately become bankrupt, which adversely affects the plan and its ability to provide secure benefits. Alternatively, if the trustees do not raise the contribution requirements adequately or pursue withdrawal liability assessments sufficiently, participant benefit security may also suffer. In order to maximize benefit security, trustees need to strike a balance between these competing objectives.

The alternative two-pool withdrawal liability approach provides an effective tool that plan trustees can use as they seek to retain contributing employers and potentially attract new employers. Concern over future increases in withdrawal liability exposure is a significant reason why employers are unwilling to participate in multiemployer plans, and to the extent that two-pool methods help address this concern, they can help plans maintain their contribution bases. These methods have the potential to allow plans to retain existing employers that might otherwise withdraw while also collecting withdrawal liability assessments.

In many cases, the cost of paying a full withdrawal liability assessment and then remaining in the plan at the same contribution rate that applies to employers in the old pool (that have not paid any withdrawal liability assessment) will be so large that no employers will choose to move to the new pool. In these cases, it may be possible for plans to offer more favorable settlement or future contribution terms to employers such that it makes financial sense for employers to move to the new pool while still placing the plan in a stronger position than it was previously.

The circumstances facing multiemployer plans vary widely. Plans have different funding levels and demographics, cover different industries and workforces, and have contributing employers with a wide range of financial and collective bargaining pressures. It is virtually impossible to develop uniform requirements on the design and implementation of two-pool methods that adequately anticipate all of these factors.

As with all decisions that trustees make, it is possible that a well-considered approach might not produce the desired results. In making their decisions, the trustees need to consider the future behavior of both employers and employees, as well as the performance of the financial markets and the industry that the plan covers. None of these can be known with certainty, which means a two-pool method might not perform as intended. Additionally, a plan that adopts such a method may already face a difficult future,



and if the funding level deteriorates after the adoption of a two-pool method, it may be that the deterioration would have been worse had the method not been adopted.

In deciding whether or how to adopt a two-pool method, there will be no one correct answer, and it may be that even with the benefit of hindsight, it will be impossible to know if the method was a success. With this in mind, the most important thing that trustees can do before making these decisions is to engage in a thorough and prudent analysis of the expected impact of the two-pool method. This analysis should include the following factors:

- Baseline actuarial projections that demonstrate that the two-pool method is expected to place the plan in a stronger position than if it is not adopted;
- Scenario and sensitivity testing that measures the impact of economic events and employer behavior that vary from what is included in the baseline projections; and
- Calibration and risk-assessment of the withdrawal liability settlement terms and new-pool contribution and benefit schedules that the trustees anticipate offering, including a comparison of the proposed settlement terms to the cost of a market (or risk-free) settlement basis.

With regard to withdrawal liability settlement terms and new-pool contribution and benefit schedules, it would be counterproductive for trustees to permanently commit to particular approaches when adopting a two-pool method. Future events will inevitably unfold differently than expected, and trustees need to have the flexibility to quickly respond with adjustments as this happens. Most significantly, the trustees should consider the above factors in deciding whether adopting a two-pool method is beneficial, and any analysis that does not consider the anticipated settlement terms and new-pool contribution and benefit schedules will be inadequate to inform a prudent decision. Additionally, these factors provide a framework for ensuring that trustees are operating in good faith. For example, if the trustees develop the analysis supporting the adoption of a two-pool method based on one set of anticipated settlement and contribution terms, and then immediately begin offering different terms to new-pool employers, it will call into question the reasonableness of their decision.

Being mindful of the varied circumstances facing plans and the uncertainties facing trustees as they attempt to protect participant benefits to the best of their ability are key considerations in developing a sound approach to evaluating proposals for two-pool withdrawal liability measures. The primary goal of any PBGC approval requirements should be to ensure that trustees have undertaken an appropriate and unbiased process to evaluate the benefits and risks of the proposed method. If the requirements are too onerous or time-consuming or the subjective judgments of the trustees are not given reasonable deference, then plans will choose not to undertake the complicated process of applying for a two-pool method and significant opportunities to benefit participants, employers, plan solvency—and the PBGC—may be lost. Lastly, it would be counterproductive for the approval process to place advance restrictions on the withdrawal liability settlement terms and new-pool contribution and benefit schedules that trustees may require or negotiate in the future. It is, however, reasonable to expect that as part of the approval process plans include expectations on these terms and schedules in their analysis supporting the adoption of the two-pool method.

**Closing**

The Multiemployer Pension Plans Subcommittee appreciates the opportunity to provide input to the PBGC on this important topic. We would be happy to discuss any of the issues raised in this letter at your convenience. Please contact Monica Konaté, the Academy's pension policy analyst (202)785-7868 or [konate@actuary.org](mailto:konate@actuary.org) if you have any questions or would like to discuss these issues further.

Sincerely,

Josh Shapiro, MAAA, FSA, EA  
Chairperson of the Multiemployer Pension Plans Subcommittee  
American Academy of Actuaries