



MCLEAN

MEMORANDUM

VIA ELECTRONIC DELIVERY

TO: Joel Dandrea
Specialized Carriers and Rigging Association

FROM: Kevin L. Wright

DATE: December 11, 2009

RE: Funding Deficiencies in Multiemployer Plans

This memorandum is in response to your request in our telephone conversation earlier this week that I comment on the correspondence [REDACTED] recently received from the [REDACTED] Pension Fund (the "Fund" or "Plan") with respect to a funding deficiency in that Plan. This memorandum is intended to briefly explain what a funding deficiency is, what many multiemployer plans are going through right now in terms of funding, short-term considerations for participating employers to consider, and longer-term strategies for consideration as well.

Funding Deficiency – What is It?

Multiemployer pension plans are governed by the funding rules set forth in the Employee Retirement Income Security Act of 1974 ("ERISA"). ERISA requires that all multiemployer pension plans maintain a "funding standard account." This is a theoretical account that is used by the government to measure the financial health of a pension plan. Whenever the plan has positive investment returns in excess of its assumed returns, those returns are credits to the funding standard account. The same is true if the plan has experience greater than assumed (for example, fewer-than-anticipated retirements in a given year). By the same token, if the plan has negative experience (less-than-assumed investment return, for example), that negative experience is a charge against the funding standard account. Benefit enhancements are also charged against the account. Most (if not all) of these charges are not taken at one time; rather, they are amortized over a period of years.

The law requires that this theoretical account maintain a positive balance at all times. If the account goes negative, then the plan has a "funding deficiency." In a multiemployer plan, all contributing employers are required to pay their pro rata portion of the funding deficiency, plus a 5 percent excise tax paid directly to the IRS. If the

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funding deficiency is not cured in a timely manner after assessment, the amount of the tax becomes 100% of the amount of the deficiency.

How the Fund Got There

As the correspondence from the Fund explains, many funds (including this one) had to increase benefits in the late 1990's to compensate for the huge investment returns many of these funds were experiencing. At that time, the maximum funding ceiling imposed by the law was artificially low, and had these funds failed to increase benefits, the employer's contributions to the plan would have become non-deductible.

Ironically, the law was changed in 2001, just as the equity markets experienced their first free-fall. Suddenly, this Fund (and many others like it) were facing the prospect of huge losses on top of benefit increases that had just been granted. In order to address the situation, the Fund applied for so-called "412(e) relief." Section 412(e) of the Internal Revenue Code, as it existed prior to 2006, permitted funds to apply for an extension of the amortization period that applies to the funding standard account referenced above. The relief, if granted, gives plans a longer period of time to amortize the losses applied to the funding standard account (and thereby forestall, or at least delay, the funding deficiency).

This fund applied for the funding deficiency, and the IRS granted this extension in 2006, retroactive to 2003. Typically, the IRS grants these extensions with conditions, such as the requirement to maintain and achieve various benchmark funded ratios during the relief period. The November 24, 2009 letter from the Fund indicates that, as a result of the market returns in the last quarter of 2008 and the first quarter of 2009, the Fund violated the funding ratio condition and other conditions also imposed. As a result, the Fund has experienced a funding deficiency retroactive back to 2004, and is required to seek payments of the deficiency amounts from the contributing employers.

Short-Term Advice to Participating Employers

Employers participating in the Fund should initially contact the Fund to explore whether the Administrator has explored asking the IRS for more time. While we have not seen the letter from the IRS granting the 412(e) relief to the Fund, we have seen similar correspondence to other funds, and they typically contain a statement that the fund must meet certain conditions, *unless extraordinary circumstances intervene*, or such similar language. The letter from the Fund indicates that they have concluded that a follow-up request to the IRS to waive the current violation "does not appear worthwhile." However, it might be worth a follow-up request to the Fund administrator as to why they believe that is the case. Certainly, other funds have concluded that approaching the IRS about a waiver of previous conditions in light of the unprecedented stock market losses in 2008 and 2009 makes sense.

Participating employers should also prepare to file an excise tax return and pay excise taxes to the IRS in the amount of the funding deficiency. The amount of

the excise tax is 5% of the amount of the deficiency. As noted in the letter, if the deficiency is paid before January 15, 2010, there should be no excise tax for the 2008 deficiency. We recommend that the excise tax return be filed and the tax paid as soon as possible to avoid a possible 100% additional excise tax.¹

Long-Term Considerations

Unfortunately, circumstances such as this illustrate the risks to employers of participating in multiemployer plans. Many times, employers are far-removed from the administration of the plans, and have no real say in how these plans are run. As a longer term strategy, we would recommend that participating employers: (1) become more involved in the administration of such plans, either by seeking appointment as a trustee to the fund or attending plan trustees' meetings as an observer; (2) regularly request and review information from the fund, including actuarial reports and estimates of withdrawal liability; and (3) consider withdrawal from the plan. Of course, withdrawal would likely trigger significant liability obligations for the withdrawing employer, which would have to be considered from an overall bargaining strategy.

Employers should also annually request estimates of withdrawal liability from the plan. These estimates, which the law requires the fund to provide upon request on an annual basis, can help the employer maintain an eye on the plan's financial health (and, of course, keep the employer up-to-date on the cost it would incur should it negotiate withdrawal from the plan).

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Please let us know if you or any of your member companies have any questions about this memo, or would like to discuss general strategies for participating in – or withdrawing from – multiemployer pension plans in more detail. With best regards.

cc: Jason M. Branciforte

¹ The timing of the excise tax, and possible imposition of the 100% excise tax for prior years, is unclear under the law. However, we believe prompt filing of the return and payment of the 5% excise tax would weigh in the employer's favor should the IRS subsequently seek imposition of the 100% tax.