SLEVIN & HART, P.C.
Attorneys at Law
WWW.SLEVINHART.COM

1625 Massachusetts Avenue, NW, Suite 450
Washington, DC 20036

14 Wall Street, 20th Floor
New York, NY 10005

# MEMORANDUM

**To:** Defined Benefit Plans Eligible for Special Financial Assistance

**From:** Slevin & Hart, P.C.

**Date:** August 4, 2022

**Re:** Final Rule on Special Financial Assistance for Multiemployer Plans under the ARPA of 2021

---

On July 6, 2022, the Pension Benefit Guaranty Corporation ("PBGC") issued a Final Rule ("Final Rule") implementing the Special Financial Assistance ("SFA") program that was established under the American Rescue Plan Act of 2021 ("ARPA") to help the funded status of certain financially troubled defined benefit pension plans. The Final Rule takes effect on August 8, 2022.

As discussed in our March 25 and July 28, 2021 memoranda regarding ARPA, the stated intent of the SFA program is to provide eligible plans with enough financial assistance to remain solvent through at least the 2051 plan year. However, the Interim Final Rule ("Interim Rule") issued by PBGC on July 9, 2021 created potential gaps that would result in many eligible plans being projected to become insolvent before 2051. Accordingly, in response to the many comments received to the Interim Rule, the Final Rule makes some significant changes, most importantly to the amount of SFA that eligible plans will receive and how plans can invest SFA proceeds.

## SUMMARY OF THE FINAL RULE

The following is a summary of the most significant changes made by the Final Rule. The Final Rule will apply to all SFA applications submitted on or after August 8, 2022. For plans that are approved for SFA prior to August 8, 2022, the Interim Rule continues to apply to the investment of SFA proceeds and the calculation of withdrawal liability until the plan files a supplemented application under the Final Rule on or after August 8, 2022. If the plan's application is currently pending with PBGC, the plan can withdraw its application and resubmit an application on or after August 8, 2022 under the Final Rule.

- Assumed Rates of Return: Under the Interim Rule, plans were required to calculate their SFA using a single interest rate assumption for plan assets, including SFA proceeds. The Final Rule allows plans to assume two different rates of return when calculating the amount of SFA – one for SFA proceeds and one for other assets. The assumed rate of return on non-SFA assets has not changed from the Interim Rule. However, under the Final Rule, plans can assume that SFA proceeds will earn a lower return, closer to 3.1% based on current rates, which will result in many plans receiving more SFA than under the Interim Rule.

- <u>Available Resources for Calculating SFA Proceeds</u>: Under the Interim Rule, the amount of SFA that a plan was eligible to receive was generally reduced by already negotiated future contribution increases. To eliminate any benefit for plans to delay negotiating contribution increases until after an SFA application is approved, the Final Rule allows plans to exclude any contribution increases agreed to after July 9, 2021, either in a CBA or other document reallocating contribution rates from their SFA calculations.

- <u>MPRA Suspensions</u>: Under the Interim Rule, plans operating under MPRA benefit suspensions were required to calculate their SFA using the same formula as plans not under MPRA suspensions. The result was to force Trustees to choose between retaining existing benefit suspensions (enabling the plan to avoid insolvency by continuing to pay reduced benefits) or applying for and receiving SFA and reinstating the suspended benefits (potentially jeopardizing the long-term financial health of the plan, which MPRA was originally intended to promote). The Final Rule resolves this concern by providing a different formula to calculate SFA for plans operating under MPRA suspensions, which is expected to result in these plans receiving significantly more SFA than under the Interim Rule. Generally, plans operating under MPRA suspensions will receive enough SFA so that they are projected to have increasing assets at the end of their 2051 plan year.

- <u>Expanded Permissible Investments of SFA Proceeds</u>: The Final Rule expands the permissible options for investing SFA proceeds. Under the Interim Rule, SFA proceeds can generally be invested only in investment grade fixed income securities. Under the Final Rule, up to 33% of SFA proceeds (including earnings on SFA proceeds) can be invested in Return-Seeking Assets ("RSAs"), which include domestic public equites, domestic corporate fixed income that is resold under Rule 144A and high yield bonds that were investment grade at the time of purchase. These investments can be made directly, or through mutual funds, exchange-traded funds and collective investment trusts of a bank or a trust company. The remaining 67% of SFA proceeds must be invested in investment grade fixed income securities consistent with the Interim Rule. Importantly, if a plan is approved for SFA based on an application filed before August 8, 2022, it can invest its SFA proceeds only in investment grade fixed income until the plan files a supplemented application on or after August 8, 2022.

- <u>Retrospective Benefit Increase</u>: Under the Interim Rule, plans that receive SFA cannot amend their plan during the SFA Coverage Period (generally until 2051) to increase benefits for service prior to the date of the amendment (referred to as a retrospective benefit increase). The Final Rule relaxes this prohibition. Beginning 10 years after the plan year in which a plan receives SFA, a plan may seek approval from PBGC for a retrospective benefit increase by demonstrating to the satisfaction of PBGC that the plan will continue to avoid insolvency, even with the increase. The rules for prospective benefit increases are largely unchanged from the Interim Rule.

- Contribution Reallocation with a Health Plan: The Interim Rule prohibited plans that receive SFA from allowing a reduction in employer contributions, either through collective bargaining or through a reallocation of contributions, with only a limited exception if the Trustees determine that doing so would reduce the risk of loss to plan participants and beneficiaries. The Final Rule creates another limited exception that allows a plan to seek PBGC approval, five or more years after it receives SFA, to have up to 10% of contributions reallocated to a health plan if the pension plan can demonstrate that the reallocation: (1) is needed to address an increase in healthcare costs required by a change in federal law after March 11, 2021, (2) does not increase the risk of insolvency for the pension plan, (3) does not result in a reduction of more than 10% of the rate negotiated for the pension plan on or before March 11, 2021, and (4) the reallocation is for no more than 10 years.

- Withdrawal Liability Calculations: The Final Rule modifies certain conditions under the Interim Rule on plans that receive SFA with respect to withdrawal liability calculations. Under the Interim Rule, plans were required to calculate an employer's withdrawal liability using the interest rate applicable to mass withdrawals (which is generally lower than the rate that most plans use for non-mass withdrawal liability calculations). The Final Rule clarifies that this mass withdrawal liability interest rate also must be used to calculate an employer's installment payment schedule, in addition to calculating the employer's withdrawal liability. In addition, to prevent plans from holding SFA money for longer than necessary, the Final Rule changes the length of time this mass withdrawal liability interest rate will apply as long as the plan is projected to have SFA money, but no less than ten years starting with the plan year after the SFA is received. Finally, the Interim Rule was silent about whether SFA proceeds are considered plan assets for the purpose of determining a plan's unfunded vested benefits. Under the Final Rule, to disincentivize employer withdrawals, for plans that file for SFA on or after August 8, 2022 (including a supplemented application), the recognition of SFA as a plan asset will be phased-in.

- Transfers and Mergers: While the Interim Rule imposed certain conditions on plans that receive SFA, it did not address the extent to which these conditions apply to a merged plan that is the product of a merger between a plan with SFA money and a plan without SFA money. The Final Rule explains how these conditions apply to a merged plan.

- New Lock-In Application Process: The Interim Rule required that certain data used to calculate a plan's SFA be based on plan assets as of the last day of the calendar quarter that immediately precedes the date on which the SFA application is filed with PBGC. Under the Final Rule, if a plan attempts to file its SFA application between March 11, 2023 and December 31, 2025 but is unable to do so because PBGC has temporarily closed the portal for filing new applications, the plan can hold its place in the submission line by filing a "lock-in application." The date the lock-in application is filed will be treated as the plan's application filing date for the purpose of calculating SFA. This means that, once a plan files a lock-in application, it can later file its SFA application without having to update its assets and related calculations and data, even if the application is filed in a different calendar quarter. However, PBGC's 120-day period to act on an application does not begin to run until the SFA application is actually filed.

- SFA Measurement Date: The Final Rule redefines the SFA measurement date as the last day of the third calendar month immediately preceding the date the plan's initial application for SFA was filed.

## RECOMMENDED ACTION

- Plans That Have Received SFA Payments: If a plan has already received SFA, it should consult with its actuary and investment consultant to determine whether the plan should file a supplemented application to take advantage of the Final Rule as soon as possible on or after August 8, 2022. That review would consider: (1) whether the plan would be eligible for additional proceeds under the Final Rule and (2) whether it should take advantage of the new permissible investment options and withdrawal liability rules.

- Plans with Pending SFA Applications: If a plan currently has its application pending, it should discuss with its actuary and investment consultant whether to withdraw its application and reapply on or after August 8, 2022 to take advantage of the Final Rule. If a plan withdraws its application, the 120-day period for PBGC to act on the application will begin to run when the new application is filed.

## FINAL RULE

### A. Determining the Amount of SFA

#### *1. Assumed Rate of Return*

As discussed in our prior memoranda, one of the most significant concerns with the SFA program is the disconnect between the expected investment return assumption used to determine the amount of SFA and how the SFA proceeds could be invested by the plan once received. Under ARPA, the amount of SFA requested by a plan must be determined using generally accepted actuarial principles and other requirements issued by PBGC. The Interim Rule generally required a plan to calculate its SFA using its assumed rate of return from its 2020 actuarial zone status certification, subject to a statutory cap (based on the IRS third segment rate in effect at the time the application is filed or the three preceding months, plus 200 basis points in either case ("SFA Rate Cap")), which is currently about 5.4%. However, the Interim Rule limited a plan's ability to invest SFA assets to only investment grade fixed income securities that are unlikely to return 5.4% over the long-term. This disconnect was expected to leave many SFA recipients with insufficient assets to remain solvent through their 2051 plan year, which was inconsistent with the stated purpose of the SFA program.

To address this disconnect, the Final Rule allows plans to calculate their SFA amount using two separate assumed rates of return – one for SFA assets and one for non-SFA assets. Non-SFA assets are still subject to the interest rate assumption under the Interim Rule. However, for SFA assets, the Final Rule allows the use of a lower assumed rate of return, which is equal to the lesser of: (1) the interest rate used by the plan in its most recently completed certification of plan status before January 1, 2021, and (2) the average of the three segment rates determined under Code Section 430(h)(2) for the month in which such average is the lowest during the 4-month period preceding the initial application date, plus 67 basis points (currently about 3.1%). The impact of this change is that most plans will receive more SFA than they would have received under the Interim Rule, increasing the likelihood of SFA recipients remaining solvent though their 2051 plan year. Thus, plans that have already received SFA should discuss with their actuary whether they will be eligible for more SFA using the lower permissible assumed rate of return for SFA assets and if so, they should consider submitting a supplemented application. Plans that have an application currently pending should discuss with their actuary whether to withdraw the application and refile on or after August 8, 2022.

*2. Calculation of Plan Resources*

The Interim Rule provides that the amount of an eligible plan's SFA is the difference between the value of the plan's "obligations" and its "resources." The Interim Rule defines a plan's resources to include the present value of future contributions, withdrawal liability payments and other amounts expected to be paid to the plan (excluding the expected SFA and any other PBGC financial assistance). Thus, any contribution increases negotiated, but not yet in effect, at a time a plan applies for SFA would increase the plan's resources and lower the amount of SFA. Based on comments to the Interim Rule, PBGC determined it was in the best of interest of plans to eliminate any incentives to delay negotiating future contribution increases. Therefore, the Final Rule allows a plan to exclude from its projection of resources any contribution increases agreed to after July 9, 2021, either under a CBA or in a document reallocating contribution rates. Plans that have already received SFA and included negotiated contribution increases in plan resources should discuss the impact of this change with their actuary to determine whether to file a supplemented application using a different plan resource amount. Similarly, plans that have an application currently pending should discuss with their actuary whether to withdraw the application and refile on or after August 8, 2022.

*3. Plans Operating Under MPRA Suspensions*

For plans operating under MPRA benefit suspensions that receive SFA, both ARPA and the Interim Rule require these plans to restore benefits that were suspended under MPRA to their pre-suspension levels, consistent with Treasury Department guidance. One of the MPRA requirements on plans that operate under benefit suspensions is an annual written demonstration that the suspensions remain necessary to avoid insolvency indefinitely. However, since plans receiving SFA are only allowed to apply for enough SFA to remain solvent through 2051, Trustees of plans operating under MPRA suspensions have faced the dilemma of deciding between restoring all retirees to full pensions until around 2051 in order to receive SFA (potentially jeopardizing the long-term health of the plan) or maintaining the suspensions to continue forestalling insolvency and foregoing SFA relief.

To relieve Trustees from having to make this choice, the Final Rule revises the methodology for calculating SFA for plans operating under MPRA suspensions to be equal to the greatest of the following amounts: (1) the amount of SFA the plan would be eligible to receive using the formula in the Final Rule for plans that are not operating under MPRA suspensions, (2) the present value of reinstated benefits, accounting for both make-up payments for previously suspended benefits as well as payments of the reinstated portion of the benefits expected to be paid through 2051 (valued using the SFA interest rate), and (3) the amount needed for the plan to project increasing assets in 2051. Since this new formula was designed to give plans operating under MPRA suspensions enough SFA so that their assets are projected to increase beginning in 2051 (rather than just avoiding insolvency), these plans are expected to receive significantly more SFA than they would have received under the Interim Rule.

### B. Permissible Investments of SFA Assets

As discussed above, the Interim Rule generally limited a plan's ability to invest SFA assets to investment grade fixed income securities. In order to help close the resulting gap between the assumed rate of return of SFA assets and how these assets actually can be invested, the Final Rule expands permissible investments for SFA assets. Under the Final Rule, plans can invest up to 33% percent of SFA assets (and the earnings on these assets), in RSAs, defined generally as publicly traded U.S. common stock, domestic corporate fixed income that is resold under Rule 144A and bonds that are no longer investment grade, provided each security was investment grade at the time of purchase. RSAs can be purchased directly or through mutual funds, exchanged-traded funds and collective investment trusts offered by a bank or trust company. SFA proceeds cannot be invested in any other asset classes, such as private assets, real estate or international securities. The remaining 67% of SFA assets may be invested only in investment grade fixed income that pays a fixed amount or a fixed rate of interest (mainly U.S or municipal bonds, U.S. Treasury bonds, U.S. government-sponsored debt securities and dollar-denominated investment grade emerging market bonds). Plans receiving SFA should work with their investment consultant to determine how to invest the SFA proceeds.

The percentage of SFA assets invested in RSAs must be measured each time the plan purchases an RSA (other than through the automatic re-investment of capital gains and dividends) and at least once during every rolling period of 12 consecutive months beginning from the date the plan receives SFA. The requirement in the Interim Rule to keep at least one year of benefit payments and administrative expenses in investment grade fixed income remains unchanged. Thus, any plan that applies (or re-applies) for SFA under the Final Rule should review its contract with its investment consultant and its investment policy to determine if changes are needed to ensure that the plan's investment program is tracked for compliance with these requirements.

As discussed in more detail below, plans that received SFA under the Interim Rule are required to submit a supplemented application under the Final Rule in order to take advantage of the investment rules under the Final Rule permitting investment of up to 33% of SFA assets in RSAs. The preamble to the Final Rule makes clear that the rules allowing for investments in RSAs apply once a plan <u>files</u> a supplemented application, even if that application is not approved. Importantly, plans that apply for SFA prior to August 8, 2022, whether or not the SFA has been received, need to submit a supplemented application in order to use the new investment rules under the Final Rule, regardless of whether the plan is eligible to receive additional SFA under the Final Rule.

## C. **Conditions on Plans that Receive SFA**

Under ARPA, PBGC may impose certain restrictions on plans that receive SFA. The Final Rule changes some of these restrictions in the Interim Rule.

### *1. Benefit Improvements*

Under the Interim Rule, a plan that receives SFA cannot be amended during the SFA Coverage Period (generally though 2051) to increase benefits attributable to prior service or previously accrued benefits (retrospective increases). The plan can adopt prospective benefit increases only if: (1) the plan actuary certifies that the cost of increasing benefits will be sufficiently offset by increases in employer contributions, and (2) those increased contributions were not included in the calculation of the SFA amount.

The Final Rule largely retains these rules but now allows a plan that receives SFA to seek approval for a retrospective benefit increase by demonstrating to PBGC's satisfaction that the plan will continue to avoid insolvency, even with the increase. This approval can only be sought 10 or more years after the end of the plan year in which the plan received SFA.

### *2. Contribution Allocations*

The Interim Rule creates certain limitations on a plan's ability to enter into arrangements that decrease the income or increase the expenses allocated to a plan that receives SFA, except for contributions under a reciprocal agreement, allocations under a cost sharing agreement, increases in the cost of services provided by an unrelated third party and decreases in contributions, provided there is no decrease in the contribution base units. The Final Rule creates another exception to allow the reallocation of contributions between a plan that received SFA and a health plan. Specifically, no earlier than 5 years after the end of the plan year during which SFA is received, a plan can seek PBGC approval to reallocate up to 10% of contributions to a health plan if the plan can demonstrate to PBGC that: (i) a reallocation in contributions from the pension plan to a health plan is needed as a result of a significant increase in health benefit costs due to a change in Federal law that goes into effect after March 11, 2021, and (ii) even with the reallocation, the pension plan is still projected to avoid insolvency.

The Final Rule also provides that any proposed reallocation of contributions cannot result in more than a 10% reduction in the contribution rate negotiated on or before March 11, 2021. Although not clear, it appears that this reduction limit of 10% applies to the contribution rate and not the contribution dollars. Finally, the proposed reallocation cannot last longer than 5 years for a reallocation request relating to any single change in federal law and no longer than 10 years cumulatively for all reallocation requests during the plan's SFA coverage period.

There are open questions regarding practical process and timing for a plan to seek approval of what typically is a bargaining party decision that we will discuss with you if this change is anticipated when it becomes available to the plan.

### *3. Withdrawal Liability*

The Final Rule makes certain changes and clarifications to the Interim Rule with respect to the calculation of withdrawal liability for plans that receive SFA. First, the Final Rule clarifies that, if an employer withdraws from a plan during the 10-year period that begins in the year after the SFA is received (or when the SFA is projected to be exhausted if more than 10 years), both the installment schedule and the lump sum withdrawal liability must be calculated using the PBGC rates applicable to mass withdrawals (currently about 2.4%). (The Interim Rule was silent as to the calculation of the installment schedule.)

Second, to prevent plans from holding a *de minimis* amount of SFA to prolong the use of PBGC mass withdrawal liability rates, the limit on the use of the rates is based on when the plan is projected to exhaust its SFA money, rather than when the money is actually exhausted. While nothing in APRA, the Interim Rule or the Final Rule requires a plan to use its SFA money before using other assets, if a plan chooses to spend its non-SFA assets before exhausting its SFA assets, it will not prolong the plan's ability to use mass withdrawal liability interest rates.

Third, the Final Rule includes a phased-in approach to recognizing SFA as part of plan assets when calculating withdrawal liability. (The Interim Rule was silent on this issue.) The phase-in period begins during the first plan year in which SFA is received and ends when the SFA is projected to be exhausted. This "phase-in" approach applies only to plans to which the Final Rule applies – those that apply for SFA on or after August 8, 2022 or that file a supplemented application.

### *4. Transfers or Mergers*

Under the Interim Rule, PBGC imposed certain restrictions on plans that receive SFA, generally through 2051. Acknowledging that a merger may include one or more plans with SFA and one or more plans without SFA, the Final Rule clarifies how the restrictions on plans that receive SFA apply to a merged plan:

- Restrictions on plans that receive SFA related to: (1) the adoption of prospective benefit improvements, (2) investing at least one year of benefit payments and administrative expenses in investment grade fixed income securities, and (3) the increase in the proportion of expenses allocated to the plan, will not apply to the merged plan following the merger.

- PBGC has discretion to approve a waiver of the restrictions related to: (1) the adoption of retrospective benefit increases, (2) contribution decreases, and (3) the reallocation of contributions and other income, if certain conditions (generally relating the proportionate value of assets and liabilities before and after the merger) are met. Absent a waiver by PBGC:

    - limits on retrospective benefit improvements will apply only to individuals who were participants in the plan that received SFA prior to the merger;

    - limits on a decrease in contributions will apply only to employers that had an obligation to contribute to the plan that received SFA prior to the merger; and;

- limits on the reallocation of contributions and other income apply only to contributions and income relative to the plan that received the SFA prior to the merger.

## D. <u>Changes to the SFA Application Process</u>

### *1. Lock-in Applications*

As permitted under ARPA, the Interim Rule created a priority system for submitting SFA applications so that the plans with the greatest need for assistance are eligible to apply first. In addition, because any application for SFA is treated as approved if it is not denied or withdrawn within 120 days of submission, PBGC can temporarily stop accepting new applications if it determines that it will be unable to review new applications within this 120-day period. Finally, when calculating the amount of SFA a plan is eligible to receive, ARPA requires that plan assets be valued as of the SFA Measurement Date, which under the Interim Rule was defined as the last day of the calendar quarter immediately preceding the filing date of the SFA application. These rules raised a concern about plans that are eligible to file having to redo their calculations each quarter they are closed out of PBGC's e-filing portal, adding unnecessary administrative expense for the plan.

To address this concern, the Final Rule allows for certain plans to submit a "lock-in" application, which is treated as an initial application for the purpose of establishing an SFA Measurement Date and other base data. Lock-in applications are available for all plans that file after March 11, 2023 and on or before December 31, 2025 in any period in which PBGC temporarily stops accepting new applications. A lock-in application is submitted electronically and must include certain specified information that is less than required for a complete SFA application. (The lock-in application instructions are on PBGC's website at www.pbgc.gov.) If a plan that meets these requirements is unable to file when its application is ready, it should discuss with its actuary whether submitting a lock-in application makes sense.

### *2. SFA Measurement Date*

Under the Interim Rule, the SFA Measurement Date was defined as the last day of the calendar quarter immediately preceding the date on which the application for SFA is filed. The Final Rule changes this definition to the last day of the third calendar month immediately preceding the date the plan's initial application for SFA was filed. For example, if the plan's application date is July 15, the SFA measurement date is April 30 under the Final Rule (rather than June 30 under the Interim Rule).

### *3. Supplemented Applications*

The Final Rule provides that, if a plan's application for SFA was approved before August 8, 2022 and the plan would be entitled to additional SFA proceeds under the Final Rule, it can submit a supplemented application on or after August 8, 2022. Importantly, even if the plan is not eligible for additional proceeds, a supplemented application permits the plan to take advantage of the Final Rule's provisions related to permissible investments and withdrawal liability calculations, even if the supplemented application is not ultimately approved. To be considered, a supplemented application must be filed before December 31, 2026 and in accordance with the processing system established under the Interim Rule (including priority groups). The plan must use the SFA measurement date that the plan used under the Interim Rule, as well as the market value of assets and participant census data used in its initial application. In addition, a plan cannot request changes to the assumptions used in the initial application, except to reflect changes under the Final Rule for the new permissible assumed rate of return on SFA assets or to propose a change to the contribution assumption to exclude contribution rate increases agreed to on or after July 9, 2021 (in which case, the plan must exclude any benefit increases resulting from those contribution increases). As with the initial application, if a supplemented application is not denied within 120 days of submission, it will be treated as approved.

If a plan applied for SFA under the Interim Rule and its application is currently pending, the plan can choose to withdraw its application and refile a revised application on or after August 8, 2022 under the Final Rule. If the pending application is not withdrawn and is subsequently approved, the amount of SFA will be determined under the Interim Rule and the provisions of the Interim Rule related to withdrawal liability calculations and permissible investments continue to apply unless the plan later files a supplemented application.

Finally, if a plan does not have an application pending as of August 8, 2022 because the plan's application was denied or withdrawn, the plan may file a revised application under the Final Rule.

Please contact us with any questions.

cc: Co-Counsel (if any)
Plan actuary

21122837v5