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: Multiemployer Defined Benefit Pension Fund Clients Eligible for Special Financial Assistance under ARPA

From: Slevin & Hart, P.C.

Date: July 28, 2021

Re: Guidance on Special Financial Assistance for Multiemployer Plans under the ARPA of 2021

As discussed in our March 25, 2021 memorandum, on March 11, 2021, President Biden signed into law the American Rescue Plan Act of 2021 ("ARPA" or the "Act"), which, among other things, provides funding relief for certain financially distressed multiemployer defined benefit pension plans through a special financial assistance ("SFA") program administered by the Pension Benefit Guaranty Corporation ("PBGC"). ARPA required PBGC to issue rules to implement the SFA program, including establishing conditions for pension plans that receive SFA.

On July 9, 2021, PBGC released an Interim Final Rule ("Rule") which offers guidance on a number of open issues under ARPA. The public has a 30-day period to comment on the Rule, which may result in further changes to the guidance before the regulations are finalized. However, unlike with many proposed rules, the Rule is effective immediately and must be followed by plans unless and until the Rule is finalized or revised. Additional information regarding SFA applications and answers to frequently asked questions can be found on a special webpage created by PBGC, https://www.pbgc.gov/arp-sfa, which includes instructions for submitting SFA applications and a template application.

Also, on July 9, 2021, the Internal Revenue Service ("IRS") issued Notice 2021-38 ("Notice"), which provides additional guidance on the reinstatement of suspended benefits under the Multiemployer Pension Reform Act of 2014 ("MPRA") for plans that receive SFA. This memorandum summarizes the requirements of the Rule and the Notice.

SUMMARY OF THE RULE

The following is a summary of the most significant aspects of the Rule, which are discussed in more detail below:

- The Rule creates a schedule of priority filing status for eligible plans to apply for SFA before March 11, 2023, based on which of the six listed priority categories the plan meets.

- It clarifies the eligibility requirements for SFA, excluding plans that elect critical status or certain plans terminated by mass withdrawal.

- It details how to calculate the amount of SFA to which a plan is entitled and explains that the calculation must take into account current plan assets, expected future contribution income and withdrawal liability payments, as well as other income that a plan expects to receive.

- It discusses the restrictions regarding how SFA proceeds can be invested but does not resolve the critical disconnect between the actual investment return likely to be earned on the SFA proceeds once received due to the Act's and Rule's investment restrictions and the investment return assumption required to be used to determine the plan's need for SFA. This disconnect creates the likelihood that the Act will not accomplish its intended goal of enabling plans to pay benefits and administrative expenses through 2051. Instead, plans that receive SFA still will be at risk of becoming insolvent before 2051 unless this issue is addressed in future regulations promptly. This is a particular area for which the PBGC is seeking comments.

- The Rule imposes conditions on plans that receive SFA, including limitations on employer contribution reductions, transfers or mergers, benefit increases and changes in the allocation of contributions among different plans.

- The Rule requires that, for employer withdrawals that occur during the 10 year period after the SFA is received, plans must calculate the employer's lump sum withdrawal liability and the present value of its installment payments (but apparently not the amount of the installment payments) using the PBGC rates applicable to mass withdrawals (currently approximately 2.1%). Thus, the employer's assessed withdrawal liability will increase and employers not subject to the 20-year cap on withdrawal liability installment payments will pay more in withdrawal liability as a result of this change.

- It provides details on the documentation and data to be provided with the application for SFA.

- It describes the process for PBGC's review of applications and the process if applications are incomplete or need to be amended.

- It requires a plan to seek approval from PBGC if, during the SFA Coverage Period, it intends to settle a withdrawal liability obligation that is more than $50 million.

IMMEDIATE ACTION ITEMS

- **Determination of Eligibility and Priority Group for SFA Application:** The Rule establishes six priority groups that determine when an eligible plan can apply for the SFA. Plans may not submit an application for SFA prior to the application period for their priority group. Since the application must be processed within 120 days, the Rule explains that PBGC may temporarily pause the acceptance of applications in each priority group once it has reached its capacity to timely review the applications already submitted. Therefore, each plan should determine whether it is in a priority group as soon as possible.

- **Application for SFA:** Once a plan has determined its eligibility for SFA and its priority group, if the Fund is eligible to file before March 11, 2023, the Board should authorize the plan professionals to prepare the SFA application, primarily working with the plan counsel, the plan actuary and the plan office. The most critical determination required as part of the application process is the amount of SFA requested and this calculation will require substantial work. As discussed below, the Rule provides detailed guidance regarding how to calculate the amount of SFA, including the actuarial assumptions and interest rate assumptions to be used. To maximize the likelihood that the plan's application will be reviewed before a pause is implemented for a particular priority group, the application should be completed and ready to be filed as early as possible during the plan's application period under the Rule (understanding that this period may be delayed by PBGC in its discretion).

INTERIM FINAL RULE

A. Eligibility for SFA

Under ARPA, a plan is eligible for SFA if it satisfies at least one of the following requirements:

1. the plan has been certified to be in critical and declining status in any plan year beginning in 2020 through 2022;

2. the plan has suspended benefits under MPRA, as of March 11, 2021;

3. the plan has been certified to be in critical status in any plan year beginning in 2020 through 2022, has a modified funded percentage (defined as the percentage equal to a fraction of the current value of plan assets plus withdrawal liability payments due over the current liabilities) of less than 40%, and has a ratio of active to inactive participants of less than 2 to 3; or

4. the plan became (and remained) insolvent after December 16, 2014 and has not been terminated as of March 11, 2021.

The Rule makes clear that, in order to be eligible for SFA, the plan must have been *certified* to be in critical status by the plan's actuary. A plan that *elected* to be in critical status under ERISA Section 305(b)(4), because it was a green zone plan that was projected to become critical within 5 years, is not eligible for SFA. The Rule also clarifies that plans that terminated by mass withdrawal in any plan year that ended before January 1, 2020 are not eligible for SFA.

To determine a critical status plan's eligibility, the Rule requires the plan to use the modified funded percentage and ratio of active to inactive participants ("Ratio") from its Form 5500 Schedule MB for a "specified year." The Rule defines a "specified year" as a plan year that begins in either 2020, 2021 or 2022, as determined by the plan sponsor. The Rule further provides that the modified funded percentage and the Ratio are not required to be the same year. For example, it appears that if a calendar year plan is certified to be in critical status during 2020, 2021 and 2022, it can use its modified funded percentage from its 2020 Form 5500 and the Ratio from its 2021 Form 5500, to determine its eligibility for SFA.

As discussed in our March 25, 2021 memorandum, to determine whether a plan is in critical or critical and declining status for the purpose of SFA eligibility, ARPA requires the plan to use the assumed rate of return used for the 2020 actuarial certification. For other assumptions, the Rule generally requires a plan to use the actuarial assumptions from its zone status certification that was completed <u>before</u> January 1, 2021, which PBGC is required to accept unless they are "clearly erroneous." The Rule does not explain what a "clearly erroneous" assumption is for this purpose. If a plan's eligibility for SFA is based on a certification completed after December 31, 2020 (e.g., the plan was first certified to be in critical status for its 2022 plan year), the plan must use the actuarial assumptions from its 2020 actuarial certification for its status determination, unless those assumptions are "unreasonable". Although the Rule does not define what is considered to be an "unreasonable" assumption, the preamble to the Rule notes that, to be considered reasonable, among other things, an actuarial assumption or method must be appropriate for the purpose of the measurement for which it being used, reflect the actuary's professional judgment, take into account all relevant current and historical data, reflect the actuary's estimate of future experience and observation of the estimates inherent in market data and must be expected to have no significant bias (for example, it is not significantly optimistic or pessimistic). If a plan proposes to change one or more of its other assumptions, it must include certain detailed information in its SFA application, including a description of why the original assumption is no longer reasonable and how the changed assumption is reasonable.

The requirement to use the 2020 actuarial assumptions reflects concerns from PBGC about plans manipulating their assumptions in order to qualify for SFA or to increase its SFA needed.

B. <u>Determining the Amount of SFA</u>

ARPA provides for eligible plans to receive SFA equal to the amount necessary to pay:

- all unreduced benefits (except for reductions made to adjustable benefits under a rehabilitation plan prior to the plan's application for SFA);

- any benefits that were suspended under MPRA; and

- any benefits that were reduced under PBGC's insolvency rules.

As discussed in our March 25, 2021 memorandum, it was unclear under ARPA whether the amount of SFA is based on: (1) the gross amount required to pay benefits through 2051; (2) that amount reduced by existing plan assets; (3) that amount reduced by expected contribution income and withdrawal liability payments; (4) that amount reduced by projected investment return under the rate used in the application; or (5) some combination of those elements.

In the Rule, PBGC has interpreted ARPA to limit the amount of SFA a plan can receive to the amount by which "plan resources" are less than "plan obligations". Specifically, the Rule provides that the amount of SFA to which an eligible plan is entitled to receive is the difference between: (1) the value of "plan obligations," determined as of the last day of the calendar quarter immediately preceding the date the plan's application is filed ("SFA Measurement Date"); and (2) the plan's resources as of the SFA Measurement Date.

For this purpose, "plan obligations" include the present value of benefits expected to be paid by the plan between the SFA Measurement Date (defined in the preceding paragraph) and the last day of the plan year that ends in 2051 ("SFA Coverage Period"). This includes the restoration of benefits that were suspended under MPRA or reduced to PBGC guaranteed levels under PBGC's insolvency rules and the present value of the plan's expected administrative expenses that will be paid during the SFA Coverage Period. The Rule explains that "plan resources" equal the sum of: (1) the fair market value of plan assets as of the SFA Measurement Date, plus (2) 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 financial assistance from PBGC). While the Rule does not specify the types of income included in "other amounts expected to be paid to the plan," it likely includes such things as payments expected to be received under a cost sharing arrangement and rental income under leases if the plan owns property.

1. *Actuarial Assumptions*

The amount of SFA requested by a plan must be determined using generally accepted actuarial principles and other requirements of the Rule. As discussed in our March 25, 2021 memorandum, ARPA requires 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 approximately 5.4%. The Rule clarifies that the plan rate for this purpose is the long-term assumed rate of return used for funding standard account purposes in the actuary's projections for the certification of plan status. All other assumptions must be the same as those used for the plan's 2020 actuarial certification, unless any of those assumptions are determined by the plan sponsor to be "unreasonable."

The preamble to the Rule notes that, to the extent the SFA is calculated by applying the same assumptions used to determine the plan's 2020 zone status, it will be subject to "far less intensive scrutiny" by PBGC when reviewing an SFA application. If a plan proposes to change one or more of its other assumptions, it must include certain detailed information in its SFA application, including a description of why the original assumption is no longer reasonable and how the changed assumption is reasonable, as well as how the change in assumption impacts the amount of SFA requested.

For assumptions about the level of future work in covered employment, expected contribution income (including contribution base units ("CBUs") and contribution rates), the plan's actuary may rely on information provided by the plan sponsor, which must act in good faith in providing the information. It is unclear what process the plan sponsor should undertake to provide good faith estimates about future work in covered employment and expected contribution income for the next thirty years (through 2051), but it is possible that future guidance will provide some examples.

Importantly, in the preamble to the Rule, PBGC recognizes that plans may not have projected thirty years of contributions and administrative expenses back in 2020, especially plans that were insolvent in 2020 or were projected to become insolvent in the future. PBGC notes that, to the extent a plan did not have these projections in 2020, the plan can extend its 2020 assumptions for the 30-year projection period, but these extensions are considered changes in assumptions, which must be specifically described in the plan's SFA application and will trigger a more scrutinizing review by PBGC. To assist plans, PBGC has developed "standard" assumption extensions that can be used to perform the thirty-year projections for plans whose original assumptions were "reasonable".

Guidelines published on PBGC's website note that PBGC will consider the following assumption changes as reasonable:

- An extension in the assumption of future CBUs, provided that the assumed CBUs are no less than the number assumed for the last full year for which the Plan projected its CBUs in 2020. For example, if a calendar year plan projected in its 2020 certification that CBUs would decrease by 2% per year over the 20-year projection period, resulting in 1,000 CBUs in year 20, PBGC will treat as reasonable, an assumption that CBUs will be 1,000 for years 21-30.

- An extension of the assumption of future administrative expenses, provided that the projections are no more than the increase assumed for last year of the period projected in 2020, adjusted to reflect increased PBGC premiums under ARPA and subject to certain limits published in the Rule. For example, if a plan assumed a 2% year-over-year increase in administrative expenses, PBGC will treat as reasonable, an assumption that administrative expenses continue to increase by 2% each year during the remainder of the 30-year projection period, subject to certain caps.

- A change in the plan's mortality table to the Pri-2012 amount-weighted Blue Collar table, with a projection scale published in the two-year period preceding the Plan's SFA Measurement Period.

- A change to the plan's contribution rate assumption if the plan uses reasonably anticipated contribution rates for the current and succeeding plan years, assuming the terms of one or more current collective bargaining agreements continue for succeeding years, unless there was a substantial decrease after March 11, 2021.

- A change to the profile of new hires if the distribution of age, service and gender are based on the characteristics of new hires and rehires of the Plan during the 5-year period preceding the SFA Measurement Date, provided that the age ranges assumed for new hires are no greater than 10 years.

2. Limitations on the Amount of SFA

The Rule provides additional scrutiny and limitations on plans that engage in certain transactions on or after July 9, 2021. In the preamble, PBGC discusses the possibility that a plan may implement certain changes or transaction in an effort to secure more SFA than was intended under the Act. In these situations, the amount of SFA is limited to what the plan would have been eligible to receive had that transaction/event not taken place. Specifically, the Rule provides that the amount of SFA will be affected if, between July 9, 2021 and the plan's SFA Measurement Date, a plan:

(a) engages in a transfer of assets or liabilities (including a spinoff);

(b) is amended to increase benefits (other than a restoration of benefits suspended under MPRA or reduced to PBGC guaranteed levels);

(c) accepts a collective bargaining agreement or enters into a participation agreement reducing an employer's contribution obligation to the Fund (even if there is a corresponding reduction in future benefit accruals); or

(d) undergoes a merger.

There are a few important exceptions described in the Rule. First, if there is a reduction in an employer's contribution obligation, including a reallocation of contributions that results in less money being contributed to the plan, it will impact the amount of SFA only if the plan is unable to demonstrate that the risk of loss to participants and beneficiaries (disregarding any SFA) is reduced by that action (e.g., that, without the reduction in contributions, a large contributing employer was expected to withdraw from the plan and file for bankruptcy so that the plan will likely not receive its withdrawal liability). Second, if a plan enters into a merger, the amount of SFA is limited to the sum of the amount of SFA that each pre-merger plan would have been eligible to receive under these Rules had the merger not taken place. For example, assume Plan A merges into Plan B effective September 1, 2021. Had the merger not taken place, Plan A would have been eligible for $100,000 in SFA and Plan B would have not been eligible for anything. Following the merger, Plan B is eligible for $150,000 in SFA. Under the Rule, the maximum SFA Plan B can receive is $100,000, which is the total amount that Plan A and Plan B would have been eligible to receive had the merger not taken place.

C. Applying for SFA

Under ARPA, all initial SFA applications must be filed by December 31, 2025 and any revised (or subsequent) applications must be filed by December 31, 2026. Under the Rule, an application will be considered filed on the date it is submitted to PBGC if it meets the applicable filing and process requirements described below and it is filed in accordance with the instructions on PBGC's website.

1. Priority of Applications for SFA

Under the Act, PBGC was permitted to prioritize the applications of certain plans. Therefore, PBGC established six priority groups in the Rule, with varying dates by which PBGC will begin accepting SFA applications:

Priority Group	*Criteria*	*Application Period Opens*
Priority Group 1	Insolvent plans and plans projected to become insolvent by March 11, 2022	July 9, 2021
Priority Group 2	Plans that have implemented MPRA benefit suspensions as of March 11, 2021 or plans that are expected to become insolvent within 1 year of the date the plan's SFA application was filed.	January 1, 2022, or an earlier date specified on PBGC's website
Priority Group 3	Plans in critical and declining status with more than 350,000 participants.	April 1, 2022, or an earlier date specified on PBGC's website
Priority Group 4	Plans projected to become insolvent by March 11, 2023.	July 1, 2022, or an earlier date specified on PBGC's website
Priority Group 5	For plans projected to become insolvent after March 11, 2023 but before March 11, 2026.	PBGC will publish on its website, at least 21 days in advance, when these plans are eligible to begin submitting applications, which will be no later than February 11, 2023
Priority Group 6	For plans projected to have a present value of financial assistance payments under the insolvency Rules in excess of $1,000,000,000 without the SFA	PBGC will publish on its website, at least 21 days in advance, when these plans are eligible to begin submitting applications, which will be no later than February 11, 2023

Other Priority Groups	PBGC may add additional priority groups based on other circumstances similar to those described above and, if added, additional priority groups and the date applications open for those groups will be posted on PBGC's website.	

PBGC will accept applications any time after a plan's priority group begins, even if other priority groups have begun to apply (meaning, for example, a plan in priority group 1 can apply at any time, even if plans in priority group 2 have already started to apply). However, since the Act provides that any SFA application that is not rejected by PBGC within 120 days of submission is automatically approved, PBGC has the authority to put a temporary hold on accepting new applications if it has reached its capacity to timely review all previously submitted applications. Therefore, plans seeking SFA should file their applications as soon as possible after PBGC begins accepting applications for their priority group.

Applications must be submitted electronically in accordance with the Rule and the SFA instructions on PBGC's website and must be submitted to PBGC consistent with the existing rules for other filings (such as such as PBGC premium filings). SFA applications that are required by the Act to be reviewed by the Department of Treasury (which are applications for all plans in a priority group) will be forwarded to Treasury by PBGC; plans are not required to file directly with Treasury.

2. Application Requirements

The Rule describes the information required in the application for SFA, including the following:

- Basic plan information – name of the plan; EIN; plan number; name and title of the individual filing on behalf of the plan; name, address, email address, telephone number of the plan sponsor and its authorized representative, if any;

- The total amount of SFA requested;

- The SFA eligibility criteria rule met by the plan. For plans in critical status, the application must include a demonstration that the eligibility requirements are met. This likely may be met by the applicable pages of the plan's Form 5500 reflecting the modified funded percentage and Ratio;

- The plan's priority group, with a demonstration of how the priority group is met. This likely may be met by the pages from the plan's actuarial valuation with the projected insolvency date. This demonstration is not required if: (1) the plan is insolvent; (2) has implemented MPRA suspensions; (3) is in critical and declining status and had 350,000 participants or more; or (4) is in priority group 6 and listed on PBGC's website;

- If the plan suspended benefits under MPRA, a description on how benefits will be reinstated, showing the aggregate amount and timing of the make-up payments;

- Copies of the:

    - current plan document with amendments
    - current trust
    - most recent IRS determination letter
    - actuarial valuations since 2018
    - current Rehabilitation Plan with any updates, with the percentage of total contributions received under each schedule during the prior plan year
    - most recent Form 5500 with all schedules
    - actuarial certifications since 2018
    - most recent statement of cash and investment accounts
    - all written policies and procedures involving withdrawal liability; and
    - bank account information for electronic transfer of SFA

- A proposed plan amendment providing that if the plan's SFA application is approved, beginning with the SFA Measurement Date, the plan will be administered consistent with the restrictions and conditions in the Rule. Additionally, a plan operating under MPRA suspensions must provide a proposed amendment regarding the repayment of suspended benefits. The application must also include a certification from the plan sponsor that the amendment(s) will be timely adopted;

- The following actuarial and financial information:

    - annual projection of excepted benefit payments (as required to be attached to the Form 5500 Schedule MB, line 8(b)(i)) for each year since 2018;
    - for plans with more than 10,000 participants, a list of the 15 largest contributing employers and their contribution amounts for the most recently completed plan year;
    - historical information for each of the most recent 10 plan years, including total contributions and total contribution base units; average contribution rates; number of active participants at the beginning of each plan year; other sources of non-investment income.
    - certain specified information and descriptions to support the amount of SFA requested, including the assumptions used (for example, a description of how the assumed future contribution income and withdrawal liability payments were determined);
    - for plans with more than 350,000 participants, census data used to develop cash flow projections

- A completed checklist;

- Any other information required on PBGC's website, if any;
- If the plan is proposing a change in an assumption for SFA purposes, additional information required by PBGC to support the proposed change; and
- If the plan has been partitioned, there are additional documents that must be included with the application.

An application must be signed and dated by a Trustee, or by another authorized representative of plan sponsor (*e.g.*, the Board of Trustees can authorize the administrative manager to sign the application) and must include a penalty of perjury statement, which appears can only be signed by an authorized Trustee. While an application is pending with PBGC, the plan sponsor must promptly notify PBGC in writing if it becomes aware that any material fact or representation relating to the application, or any supporting documents, is no longer accurate, or that any material fact or representation was omitted from the application or supporting documents.

PBGC notes in the preamble to the Rule that information provided to PBGC in support of an SFA application is not subject to confidentiality and may be made publicly available on PBGC's website, in PBGC's sole discretion.

D. PBGC Review of Applications

ARPA gives PBGC 120 days from the date an application is submitted to make a decision regarding that application. A plan may withdraw its application by written notice to PBGC by any person authorized to apply on behalf of the plan. An application can be withdrawn at any time prior to its approval. However, an application cannot be withdrawn after the application has been approved or deemed approved (following 120 days after the submission without rejection).

The Rule states that PBGC may deny an application for any of the following reasons: (1) the application is incomplete; (2) an assumption is unreasonable or a proposed change in assumption is individually, or in the aggregate, unreasonable; or (3) the plan is not eligible for SFA. If the PBGC denies an application for any of these reasons, PBGC is required to notify the plan of the reason for the denial in writing and, if the application is incomplete, notify the plan sponsor of the missing information.

Following receipt of a denial, the plan may submit a revised application or withdraw the denied application. In any revised application, the plan must use the data and projections from its initial application, including the actuarial assumptions, unless changes are required by PBGC to address the reason for the initial denial.

E. Payment of SFA

If the plan's application is approved, the amount of SFA paid to the plan will be equal to: (1) the amount of the SFA requested in the plan's application; (2) increased by the interest on that amount at a rate that is equal to the interest rate assumption the plan is required to use to calculate the SFA, from the SFA Measurement Date through the date on which PBGC sends payment to the plan (not the bank settlement date). For insolvent plans, it appears that, when determining the amount of SFA that a plan will receive, PBGC will credit the amount of any financial assistance it provided to the plan that is required to be repaid, reduced by any additional financial assistance paid between the SFA Measurement Date and the date on which the SFA is paid to the plan. If the plan is required to repay PBGC under the terms of the promissory note executed upon its insolvency, PBGC will issue written demand to the plan when the SFA application is approved and deduct the amount owed to PBGC under the promissory note from the amount of SFA paid to the plan. The net impact of this appears to be that the SFA paid to an insolvent plan will be reduced by the amount of PBGC financial assistance paid to the plan in that period.

The Act requires that SFA proceeds be paid to a plan no later than one year after the plan's application is approved. The Rule provides that PBGC expects to make SFA payments in a lump sum within 60 days after approval of the SFA application, but no later than the earlier of: (1) 90 days after a plan's SFA application is approved by PBGC or deemed approved; or (2) September 30, 2030.

PBGC will adjust the amount of SFA paid to a plan as necessary to correct any clerical errors in the plan's application. In addition, if PBGC determines that a payment exceeds the amount to which the plan is entitled, the excess payment is considered a debt to the federal government that must be repaid. If the excess is not repaid within 90 calendar days of receipt of a demand, PBGC may take any action permissible under law, including the assessment of interest.

F. Conditions After Receipt of SFA

Under ARPA, plans that receive SFA are subject to restrictions both on the SFA and on other aspects of plan operations. (However, these restrictions do not include the more intrusive governance restrictions that were part of prior multiemployer funding relief proposals introduced before ARPA.) ARPA includes restrictions on the use and investment of the SFA funds, requires the reinstatement of suspended benefits under MPRA and benefits reduced for insolvency, and provides that plans that receive SFA are ineligible to apply for future benefit suspensions under MPRA. In addition, the Act allows PBGC to impose other reasonable conditions on plans that receive SFA. The Rule provides details on the statutory obligations as well as adding several new limits, as discussed below.

1. Permissible Investments of SFA

The SFA and any earnings thereon may be used by the plan only to pay benefits and administrative expenses. The SFA must be segregated from other plan assets, and may, but is not required to, be used before other plan assets. As discussed in our March 25, 2021 memorandum, the Act limits how SFA proceeds can be invested to investment grade fixed income denominated in U.S. dollars and other asset classes permitted in guidance issued by PBGC ("Permissible Investments"). The Rule clarifies that Permissible Investments may be held as individual securities or through permissible fund vehicles, which include exchange traded funds, mutual funds, pooled trusts, or other commingled funds whose investable assets are limited to investment-grade fixed income securities denominated in U.S. dollars, with an average credit quality, weighted by market value.

The Rule generally defines "investment grade" to include any publicly traded security for which the issuer is able to meet the financial commitments under the security for the projected life of the asset or exposure. Whether a security is considered "investment grade" must be determined by a fiduciary who is, or seeks the advice of, an experienced investor, such as the plan's professional investment advisor. This would appear to permit the plan trustees to delegate the determination of investment grade to an investment manager to build a portfolio that meets these criteria. The Rule also allows up to 5% of the aggregate market value of a plan's assets attributable to SFA to remain invested in securities that were investment grade at the time of purchase but are no longer investment grade. Consequently, the SFA investments will need to be monitored for this additional limitation and timely action must be taken, by the plan trustees or the investment manager, as applicable, in the event the 5% limit is approached.

The Rule also provides that, at all times during the SFA Coverage Period, the plan must maintain at least one year of benefit payments and administrative expenses (or until the projected insolvency date if at any time that is less than one year) in Permissible Investments. For example, if a plan chooses to use its SFA prior to other assets when paying benefits and expenses and as a result, prior to 2051, the plan runs out of SFA (or has less than 1 year of SFA money remaining), it must transfer to Permissible Investments, at least enough assets to cover benefit payments and administrative expenses for the next 12-month period.

As discussed in our prior memorandum, 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 can be invested by the plan once received. This disconnect is not resolved by the Rule. As discussed above, when determining the amount of SFA an eligible plan is entitled to receive, the plan must assume a return on the segregated SFA of approximately 5.4% (unless the plan's long-term assumed rate of return used to calculate the funded standard account is less). However, Permissible Investments are unlikely to return that amount over the long-term.

Consequently, under the current law, it is likely that, even if the plan's projections related to resources and obligations through 2051 are accurate, the SFA proceeds will be insufficient to pay all accrued benefits and plan expenses through 2051. Since the Act does not restrict how assets other than the SFA can be invested (except the requirement to maintain at least one year of benefits and expenses in Permissible Investments), trustees should consult with their investment consultant and actuary regarding the best way to address the investment of the non-SFA assets, consistent with the board's fiduciary duties. This disconnect creates pressure on plans to seek to fill this gap by investing their non-SFA assets in more volatile investments that may compound the risk of early insolvency created by this aspect of the Rule. For example, plans may decide to modify their current asset allocation to move more of the non-SFA assets into equities and alternatives in recognition of the fixed income exposure for the SFA assets.

In the preamble to the Rule, PBGC acknowledges this disconnect and specifically seeks comment on whether other types of investments that generally replicate fixed income (e.g., insurance contracts, hybrid securities, preferred stock) would be appropriate ways to achieve additional returns without incurring additional risk. Therefore, it is possible that final regulations will include additional classes of permitted investments before most eligible plans actually receive the SFA.

2. *Contribution Decreases, Allocating Contributions, and Other Practices*

During the SFA Coverage Period, a plan cannot accept a collective bargaining agreement or other agreement requiring contributions to the plan that reduces the level of contributions or CBUs to the plan from those in effect on March 11, 2021, unless the plan sponsor determines that it would reduce the risk of loss to plan participants and beneficiaries. For example, the trustees may determine that, without a contribution decrease, a large contributing employer would go out of business and be financially unable to pay its withdrawal liability to the plan. If a proposed reduction in contributions or CBUs impacts annual contributions by more than $10 million and more than 10% of all employer contributions, the plan must submit a request to PBGC for approval.

The Rule also generally prohibits a plan that receives SFA from entering into a new written or oral agreement after March 11, 2021 (*i.e.*, a reciprocity agreement or cost sharing agreement) under which income or expenses are divided between a plan that receives SFA and another plan, to the extent that such an agreement results in a decrease in the proportion of income or an increase in the proportion of expenses allocated to a plan that receives SFA during the SFA Coverage Period.

3. *Prohibition on Increasing Benefits*

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. In addition, plans that receive SFA cannot be amended to increase future benefits during the SFA Coverage Period unless: (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. This is similar to the limits on benefit increases for critical zone plans.

4. *Reinstatement of Benefits Previously Suspended/Reduced For Insolvency*

The Act requires that, if a plan that suspended benefits under MPRA or reduced benefits under the insolvency rules receives SFA, it must restore all the previously suspended/reduced benefits to affected participants and beneficiaries. IRS Notice 2021-38 provides guidance regarding this requirement for plans that suspended benefits under MPRA, generally requiring that effective as of the first month in which the SFA is paid to the plan, the plan must make payments equal to the amount of all benefits previously suspended to any participants or beneficiaries in pay status as of the date the SFA is paid.

For benefits suspended under MPRA or reduced for insolvency, the plan must choose whether the make-up payments will be made: (1) in a single lump sum payment no later than three months after the date that the SFA is paid to the plan; or (2) in equal monthly installments over a period of five years, with no adjustment for interest, beginning no later than three months after the date that the SFA is paid to the plan. The trustees should review the impact of this choice on the plan's projected finances, including the potential incremental return on the SFA assets if paid over five years versus as a lump sum.

The Notice also appears to provide that, if a plan chooses the monthly payment option, the make-up payments will not be treated as eligible rollover distributions. Alternatively, if the trustees choose the lump sum option, and any individual's lump sum payment exceeds the greater of $750 or 10% of that individual's annual benefit amount, then the make-up payment must be treated as an eligible rollover distribution.

Plans must also issue a notice of reinstatement to participants and beneficiaries whose benefits were previously suspended or reduced and then reinstated, the requirements and instructions for which are on PBGC's website.

5. Withdrawal Liability

For any employer that withdraws from a plan during the 10 year period that begins in the year after the SFA is received (or when the SFA is used up if less than 10 years), the employer's lump sum withdrawal liability and the present value of its installment payments must be calculated using the PBGC rates applicable to mass withdrawals (which is currently approximately 2.1%). Since these rates are generally less than the rate that most plans currently use, the effect will be an increase in the assessed withdrawal liability for employers.

The Rule does not appear to address the calculation of the employer's installment payments and therefore, absent further clarification, that formula has not changed. As a result, plans that receive SFA should expect assessments of longer withdrawal liability installment schedules and a greater number of withdrawal liability assessments subject to the 20-year cap.

In addition, the plan must seek approval from PBGC if, during the SFA Coverage Period, it seeks to settle a withdrawal liability obligation that is more than $50 million, calculated as the lesser of: (1) the allocation of unfunded vested benefits; or (2) the present value of withdrawal liability payments assessed against the employer, discounted using the mass withdrawal interest rate assumptions. PBGC will approve a proposed settlement if it determines that implementation of the settlement is in the best interests of the plan's participants and the settlement does not create an unreasonable risk of loss to PBGC.

6. Transfers or Mergers

A plan that seeks to engage in a merger or a transfer of assets and liabilities after receiving SFA must seek approval from PBGC prior to entering into any such transaction. PBGC will approve a proposed transaction if it: (1) satisfies the current requirements of ERISA for mergers and transfers; (2) is not expected to increase the risk of loss to PBGC with respect to any of the plans involved in the transaction; and (3) is not expected to be adverse to the interest of the participants or beneficiaries of the plans involved in the transaction.

7. Reporting and Audit

Beginning with the plan year after the payment of SFA and through the last day of the last plan year ending in 2051, a plan sponsor must file an annual statement with PBGC certifying its compliance with the terms and conditions of the SFA. The certification must be filed no later than 90 days after the end of each plan year and be signed and dated by an authorized Trustee or other authorized representative of the plan. In addition, PBGC may conduct periodic audits of a plan that has received SFA to review a plan's compliance with the Act and Rule.

We will continue to monitor for additional guidance regarding implementation of the SFA program, and we look forward to discussing the Rule with you.

cc: Co-Counsel (if any)

20995947v1