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New COVID-19 Stimulus Bill Includes Significant Pension Reforms and Expands Scope of 162(m) Compensation Deduction Limit

March 10, 2021

Today, the House of Representatives passed the $1.9 trillion American Rescue Plan Act of 2021 (the "ARPA"). The ARPA has already been approved by the Senate and is expected to be quickly signed into law by President Biden. This client alert addresses Title IX, Subtitle H of the new legislation, which includes significant pension reforms for multiemployer and single-employer pension plans, and expands the number of covered employees for the limitation on the deductibility of executive compensation under Section 162(m) of the Tax Code.

Multiemployer Pension Reforms

Special Financial Assistance for Severely Underfunded Multiemployer Plans

Background

The multiemployer pension system in the United States is currently in crisis, with over 100 multiemployer pension plans, covering more than one million participants in total, projected to become insolvent within the next 10 to 20 years. The largest and most significant of these plans, the Central States, Southeast and Southwest Areas Pension Fund (the "CSPF"), is projected to become insolvent by 2025. Under existing law, the Pension Benefit Guaranty Corporation (the "PBGC") provides financial assistance to a plan after it becomes insolvent that is sufficient to allow the plan to continue paying benefits up to the level guaranteed by the PBGC. However, the scope of the crisis, and the pending insolvency of the CSPF, is projected to cause the PBGC's own multiemployer insurance fund to become insolvent by 2026. This issue has created significant concern among individual participants, contributing employers, unions, and plans themselves. As a result, Congress has previously made several attempts to enact a legislative solution, including the establishment of the bicameral Joint Select Committee on Solvency of Multiemployer Pension Plans in 2018, but these attempts have largely failed to date.

The ARPA attempts to address these issues by creating and funding a special financial assistance program intended to extend the solvency of severely underfunded multiemployer plans, including the CSPF, by providing one-time payments intended to allow the plans to continue paying all benefits through 2051, which in turn should also allow the PBGC's existing multiemployer insurance fund to avoid insolvency. Importantly, and unlike many previous proposals, there is nothing in the ARPA that requires plans that receive the special financial assistance to repay the assistance.

Eligibility

A multiemployer plan is eligible for financial assistance if it satisfies any of the following criteria:

- The plan is in "critical and declining" status in any plan year beginning in 2020 through 2022;
- The plan had a suspension of benefits in accordance with the Multiemployer Pension Reform Act of 2014 ("MPRA") as of the date of enactment;
- The plan is in "critical" status in any plan year beginning in 2020 through 2022, has a "modified" funded percentage of less than 40% (it appears that the modified funding percentage for this purpose is determined in the same manner as the percentage reported on Line 2C of Schedule MB for the Form 5500), *and* has a ratio of active to inactive participants that is less than 2:3; or

- The plan became insolvent after December 16, 2014, remains insolvent, and hasnot been terminated as of the date of enactment.

Application Procedures

An eligible plan must first apply to the PBGC for special financial assistance by December 31, 2025. The PBGC is required to issue regulations regarding the application requirements within 120 days of the date of enactment. Notwithstanding the application process, the ARPA only permits the PBGC to deny assistance to a plan if its application is incomplete, any proposed change or assumption as part of the application is unreasonable, or the plan is not eligible. Applications are deemed to be approved unless the PBGC notifies the plan otherwise within 120 days after an application is filed.

The ARPA also allows (but does not require) the PBGC to give priority consideration to certain plans by prohibiting a plan from submitting an application for up to two years from the date of enactment unless the plan satisfies any of the following criteria:

- The plan is insolvent or likely to become insolvent within five years after the date of enactment;
- The PBGC projects that the plan would receive more than $1 billion in financial assistance following its insolvency if the special financial assistance is not provided;
- The plan has suspended benefits in accordance with the MPRA as of the date of enactment; or
- The PBGC determines it appropriate based on other similar circumstances.

Terms of Special Financial Assistance

An eligible plan will receive a one-time special financial assistance payment from the PBGC within one year after its application is approved equal to the amount necessary to ensure that the plan can pay all benefits due (other than any adjustable benefits that were eliminated before the application) through the last day of its plan year ending in 2051. Absent strong investment returns on an eligible plan’s existing assets that are not subject to the investment restriction described further below, it appears that a plan receiving special financial assistance would become insolvent soon after 2051.

Subject to certain limitations, the amount of special financial assistance will generally be determined with the actuarial assumptions used by the plan for its most recently completed certification of plan status before January 1, 2021 unless they have become unreasonable. The limitations include that the interest rate used to calculate the special financial assistance is capped at the unadjusted IRS "third segment rate" (which is based on long-term corporate bond rates) for single-employer pension funding with respect to the month in which the application is filed or the three preceding months, plus 200 basis points in either case.

The special financial assistance received by an eligible plan is subject to certain restrictions, including that the assistance must be segregated from other plan assets and must be invested in investment-grade bonds or other investments approved by the PBGC. A plan that receives financial assistance under this legislation will be deemed to be in "critical" status until the end of its plan year ending in 2051. In addition, a plan that previously suspended benefits in accordance with the MPRA must reinstate its suspended payments and provide retroactive adjustments to affected participants and beneficiaries, which can be paid in a lump sum or in installments over a five-year period.

The PBGC may impose other reasonable conditions on the receipt of the special financial assistance, including with respect to benefit increases, asset allocation, reduction in contribution rates and withdrawal liability, but the conditions cannot relate to any prospective reductions in benefits, plan governance, or funding rules.

Impact on Employer Withdrawal Liability

A prior version of the ARPA specified that any special financial assistance received by a plan would be disregarded in calculating withdrawal liability until the first plan year beginning after the 15th anniversary of the plan's receipt of the financial assistance, but this provision was removed from the final bill for what appears to be procedural reasons. It remains to be seen whether the PBGC will condition special financial assistance on a plan's agreement to implement a similar withdrawal liability rule.

Other Provisions Affecting Multiemployer Plans

The ARPA also includes other reforms that impact multiemployer plans, as further described below.

Multiemployer PBGC Premium Increase

For plan years beginning after December 31, 2030, the multiemployer PBGC premium will increase from $31 per participant to $52 per participant, and the premium will be subject to indexed increases for plan years beginning after December 31, 2031. While this increase is significant (even after taking into account that premiums were going to be indexed for inflation in any case), it is still far less of an increase than was included in a number of prior proposals. There is no change to single-employer PBGC premiums.

Temporary Delay for Designation of Funding Zone Status

A plan may elect to retain for its first plan year beginning during the period that starts on March 1, 2020 and ends on February 28, 2021, or the next succeeding plan year, the status of the plan for the year immediately prior to the year elected by the plan. A plan that was already in endangered or critical status during the applicable prior year is not required to update its funding improvement plan or rehabilitation plan, as applicable, for the year elected by the plan.

Temporary Extension of Funding Improvement and Rehabilitation Periods

A plan in endangered or critical status for a plan year beginning in 2020 or 2021 may elect to extend its funding improvement or rehabilitation period, as applicable, by five years.

Adjustments to Funding Standard Account Rules

A plan (assuming it meets a solvency test) may elect to amortize over 30 years, rather than the normal 15 years, certain experience losses incurred in the first two plans years ending after February 29, 2020. A plan that makes this election would not be permitted to increase benefits during the period and the two years thereafter (unless funded with additional contributions). While this is similar to a provision enacted after the 2008 global financial crisis, it differs in that it takes into account both investment losses and other losses related to COVID-19. Thus, for example, losses due to reduced contributions or deviations in employment or retirement rates that resulted from COVID-19 could be amortized over the longer period.

Also similar to the relief granted post-2008, a plan (again assuming it meets a solvency test) can smooth over 10 years (rather than five) actuarial investment losses for the first two plan years ending after February 29, 2020 (as long as the value of the plan's assets remains within an 80-130% range of their market value). A plan that elects this relief is also subject to limitations on benefit increases.

Relief for Single-Employer Pension Plans

"Fresh Start" and Extended Amortization Funding Shortfalls

The ARPA provides a "fresh start" on the amortization of a single-employer plan's underfunding. For the plan year beginning in 2022 (or, if elected by the plan sponsor, a plan year beginning in 2019, 2020, or 2021), all of the plan's shortfall amortization bases for plan years preceding the applicable plan year will be reduced to zero. Beginning in the applicable plan year, the plan's new shortfall amortization base (and any future shortfalls) will be amortized over fifteen years, instead of seven years. This relief will reduce the annual minimum required contributions for single-employer plans.

Extended and Enhanced Interest Rate Stabilization

Beginning in 2012, Congress enacted certain interest rate stabilization provisions intended to smooth pension interest rates by setting a floor and a ceiling on the rates used to calculate pension liabilities. However, the floor and ceiling rates—also known as the interest rate corridor—would have begun to phase-out in 2021, increasing pension liabilities amidst historically low interest rates.

The ARPA will hold the interest rate corridor at 5% (thereby allowing plans to use higher rates, which in turn reduces the value of their liabilities) from 2020 through 2025. Beginning in 2026, the corridor will annually increase by 5% until it reaches, in 2030, 30%, which is where it would remain. However, the ARPA also sets an interest rate floor of 5% on the 25-year average on which the corridor is based.

The interest rate stabilization changes are effective for plan years beginning in 2020. However, a plan sponsor may elect to delay the application of the changes to any plan year beginning before January 1, 2022, in which case the plan sponsor may elect the delay to apply for all purposes or just for purposes of calculating the plan's adjusted funding target attainment percentage ("AFTAP"), which is used to determine whether the plan is subject to funding-based benefit restrictions.

Community Newspaper Plans

The Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act") enacted by Congress in 2019 included special funding rules for single-employer plans sponsored by "community newspapers," which are generally family-owned, non-publicly traded, independent newspapers. The ARPA expands the SECURE Act's special funding rules for these types of plans to include additional community newspapers.

Expansion of Covered Employees Subject to 162(m) Compensation Deduction Limit

Section 162(m) of the Tax Code generally prohibits a public company from deducting more than $1 million in compensation paid to a current or former covered employee in a taxable year. Under current law, the covered employees are the chief executive officer, chief financial officer, and the three other highest compensated officers for the taxable year. An employee who meets this criteria in any taxable year is permanently treated as a covered employee of the company for all subsequent years, regardless of whether the employee continues to the meet the criteria.

The ARPA provides that effective for any taxable year beginning after December 31, 2026, the covered employees for a taxable year will also include the company's five highest compensated employees in that year (in addition to the chief executive officer, chief financial officer, and three other highest compensated officers). However, unlike other covered employees, these additional five employees will not become permanently treated as covered employees and will be re-determined each year.

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Many details regarding the implementation of these provisions under the ARPA remain open, and we anticipate regulatory and other guidance from the PBGC and the IRS to help resolve all or some of these questions. As noted above, the PBGC is required to issue regulations regarding applications for special financial assistance within 120 days of the date of enactment.

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Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. We will continue to evaluate the CARES Act, the Consolidated Appropriations Act, 2021, related regulations and any subsequent legislation to provide our clients guidance in real time. Please visit our Coronavirus Resource Center for guidance on risk management measures, practical steps businesses can take, and resources to help manage ongoing operations.

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