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‘Hybrid Multiemployer Plans’: An Attempt to Limit Withdrawal Liability

In efforts to limit potential costly withdrawal liability, some multiemployer defined benefit funds are making the transition to a new species being referred to as ‘‘hybrid multiemployer plans.’’

A hybrid multiemployer plan is a defined benefit plan with two withdrawal liability pools, one for existing employers and the other for new employers and employers that elect to pay off their current withdrawal liability in order to be treated as a new employer, Charles B. Wolf of Vedder Price, Chicago, told BNA Aug. 27.

James B. Dexter of Dexter Hofing, Philadelphia, speaking on behalf of the American Academy of Actuaries, told BNA Aug. 21 that hybrid multiemployer plans ‘‘do not cure withdrawal liability. Instead, they attempt to isolate the existing withdrawal liability so that new participating employers are far less likely to end up with withdrawal liability. In some cases, they’ve also given existing employers the opportunity to withdraw, pay liability, and then immediately re-enter the plan as a ‘new’ employer. For an existing employer, that move is intended to make it less likely that the employer will accrue additional withdrawal liability beyond that which they incur in the withdrawal/re-entry process.’’

David R. Godofsky, a partner at Alston & Bird, Washington, told BNA Aug. 17 that ‘‘he has reason to believe this will be a trend.’’

However, Dexter said he does not see a lot of plans doing this. The complexity and amount of time negotiating each deal makes it unlikely, he said.

So far, these hybrid plans have been adopted by the New England Teamsters & Trucking Industry Pension Fund and the Central States, Southeast and Southwest Areas Pension Plan. These two plans have a large number of participants. According to the Form 5500s filed with the Department of Labor, the Central States fund has about 416,000 participants with 2,057 contributing employers, and the New England Teamsters fund has almost 74,000 participants with about 400 contributing employers. Existing employers must decide whether they want to enter the new withdrawal liability pool.

Those interviewed by BNA agreed that whether a plan should add this new withdrawal liability method should be decided on a case-by-case basis by each employer. In addition, it is a complicated issue because the plans that have adopted this method do not do it in a uniform manner, Wolf said.

‘‘The variation in design details reflect the process of give and take at the board of trustees level,’’ Thomas B. Lowman, the chief actuary at Bolton Partners Inc., Baltimore, told BNA Aug. 21.

How It Works

In a hybrid multiemployer plan, the current employer (Company X) will pay the current amount of withdrawal liability and thereafter have the withdrawal liability calculated using a method in which only Company X’s employees’ benefits and Company X’s contributions are factored in, Godofsky said. After paying the current amount of withdrawal liability (which will include unfunded benefits for other companies), Company X no longer worries about the liabilities being accumulated for other employers. The plan is offering Company X the opportunity to reduce risk by paying now, he said.

For example, Central States is offering discounted withdrawal liability deals, but the employer must commit to five years of future contributions at a specified level and the employer must actually pay the withdrawal liability in a lump sum or otherwise secure such payment, Wolf said. ‘‘This may be attractive to an employer who can afford to pay and who believes that the withdrawal liability will only increase in the future,’’ he said.

Dexter said creating the new pool is a ‘‘bookkeeping matter’’ for withdrawal liability purposes. From the point of view of participants, there is no change at all, he said. If a pension fund changes to a withdrawal liability method that is not listed as an approved method in the Employee Retirement Income Security Act, then the fund must request approval for the method from the Pension Benefit Guaranty Corporation. The board of trustees can make the change effective immediately, he added.

Edward F. Groden, the executive director of the New England Teamsters Pension Fund, told BNA Aug. 24 that the fund obtained two PBGC approvals, the first for the establishment of the new withdrawal liability pool and the second to use the direct attribution method in computing withdrawal liability in the new withdrawal liability pool.

The Pros of Creating a New Withdrawal Liability Pool

Groden said that a benefit for employers that enter the Teamsters’ new withdrawal liability pool is that ‘‘they are able to stabilize and fix their pension costs for an extended period of time by agreeing to a fixed payment schedule for the existing withdrawal liability extending over an expanded payment period and also by negotiating a contribution rate that will be fixed for the term of the contract and possibly beyond.'' Without making this transition, contribution rates are required to increase annually by a rate of 6 percent to 10 percent under the terms of the Teamsters fund's rehabilitation plan, he said. The Pension Protection Act requires that plans that are defined as ''critical'' because of their underfunded status must institute rehabilitation plans. Groden said the new pool is a component of Teamsters fund's rehabilitation plan.

In addition, the direct attribution method allows each company to stand on its own with respect to withdrawal liability in the second withdrawal liability pool, Groden said. Accordingly, as part of the transition negotiations, the contribution rate applicable to the negotiated pension accrual is independently set for each employer based on that employer's demographics, he said.

Lowman said a possible benefit is that, in moving to the new pool, employers might be able to take a ''haircut'' on the withdrawal liability they owe.

In addition, Lowman said that, if many employers make the election, the ''doubling up'' of the withdrawal liability payment and ongoing legacy cost payments built into the regular hourly rate contribution will help the plan.

''Regardless of the risk, the positive benefit of recapitalization is significant,'' he said, and ''this would be attractive to the plan and the government regulators.'' Also, there are benefits to the plan if new employers now feel they are able to join the plan and no existing employer elects to change, Lowman added.

The Cons of Creating a New Withdrawal Liability Pool

Groden said a possible deterrent is that there will be higher total pension contributions costs (withdrawal liability payments plus ongoing contributions) for a few years after the transition. Usually, this time period is about four to seven years, depending on the specific circumstances of each employer, he said.

Another deterrent is that the new pool could still have liability. However, Dexter said this is unlikely because the balance of current contributions to current benefit accruals is generally quite favorable in these plans (due to benefit accrual rate reductions, with much of the current contribution needed to pay legacy liabilities).

An important factor that an employer needs to consider is the ''balance sheet effect,'' Dexter said. ''While accepting a 'deal' may reduce an employer's long-term liability, it does have the immediate effect of moving an off-balance sheet liability onto the balance sheet,'' he said. As a result, the liability would be ''visible to the world,'' and it might violate certain loan covenants, he added.

Wolf agreed that some plans may think that adopting a hybrid program would call unwanted attention to the unfunded status of the plan and differentiate between groups of employers in an undesirable way.

In addition, if the old pool's liability decreased in the future, the new pool would have unnecessarily paid more than it had to, Godofsky said.

Groden said that in the Teamsters' hybrid multiemployer plan, the second withdrawal liability pool could produce withdrawal liability due to poor returns on investments. But, he said, that possibility is mitigated by a provision in the transition agreement whereby any emergence of withdrawal liability for an employer would require the fund to notify the bargaining parties (the employer and the local union) as to the additional funds needed to rectify the situation. If no additional funds are allocated, the fund will reduce future pension accruals for the employer's employees to eliminate withdrawal liability, he said.

Pension Fund Perspective

Groden said that the trustees of the New England Teamsters & Trucking Industry Pension Fund originally adopted a new withdrawal liability pool as a means of attracting new employers to the fund without exposing them to the existing unfunded vested liability. In addition, existing employers can join the new withdrawal liability pool if they negotiate and agree to withdrawal from the existing withdrawal liability pool, agree to a withdrawal liability payment schedule, and re-enter the fund as a transitional new employer participating in the new withdrawal liability pool for contributions made and benefits earned after the date of transition, he said.

Groden said the feedback from the employers has been very positive. The fund has about 400 contributory employers, he said. To date, the fund has 17 signed agreements with existing employers that have agreed to withdraw from the existing withdrawal liability pool and re-enter the fund as a transitional new employer, he said. These companies employ nearly 10 percent of the employees in the fund. Currently, the fund is actively engaged in transition negotiations with another 30 employers, he said. In addition, the fund has responded to requests for information about making the transition with another 30 employers that have elected to not negotiate at this time, he said. The local unions have been instrumental in negotiations with the employers, and the members are extremely positive about the transition process and strategy, he added.

Practitioners' Views. Wolf said that he thinks ''the 'hybrid proposal' is well worth considering for an employer who can afford to pay the liability, although it is ultimately a question of business judgment (and perhaps actuarial judgment) and there are plenty of uncertainties about future events that may affect the decisionmaking process.'' There are several points to consider, Wolf said:

- Old-pool liability could actually decrease in the future, either due to high investment returns or a government bailout.

- There is no guarantee that the new-pool employers will be free of withdrawal liability. Either very poor investment returns or the total collapse of the old pool could cause the new pool to have liability.

- To the extent that the employer wants to stay in the plan to protect the interests of its employees, there is no guarantee that the employees' benefits will not be reduced in the future. As plan insolvency approaches, a union's support of the plan could be affected.

- An employer's decisionmaking process may be affected by the time horizon in which it expects to remain in business, whether the employer believes that the business can be sold if there is no withdrawal liability, whether its employees will be in a better position to incur a rehabilitation plan withdrawal a few years down the road than they are now, and many other business factors. Some employers may conclude that they can and should simply drop out of the plan and pay the withdrawal liability instead of paying the liability and continuing to participate as a ''new'' employer.

Dexter said, ''In our experience, the decision as to whether or not to withdraw is largely driven by nonpension factors. In many cases, we've seen the employer would prefer to withdraw, but that desire is outweighed by the adverse business consequences (i.e., a strike). We have reviewed such proposals for a number of employers looking at what happens either with or without accepting the 'deal' if (a) they remain in the plan indefinitely, (b) various scenarios in which they withdraw after a number of years, or (c) various scenarios in which there is a mass withdrawal after a number of years. An employer may well see that the 'deal' is the best choice under a number of scenarios while 'no deal' is better under others. Then the employer needs to make a judgment as to which scenarios are the most likely. It really requires a careful case-by-case analysis for each employer.''

Dexter added that ''it's clear that in the short run, the new pools are far less vulnerable to withdrawal liability than the old. However, as time goes on, unless some fundamental changes are made (e.g., asset/liability matching), they face the same sort of risks that have caused existing plans to develop large amounts of unfunded liability.''

''An important factor to consider as an employer analyzes such deals is the extent to which accepting the deal may change future contribution obligations (e.g., allowing a lower contribution rate prospectively and/or limiting or eliminating otherwise required contribution increases under the rehabilitation plan),'' Dexter said.

Another factor an employer needs to consider is the balance sheet effect, he said. ''While accepting a 'deal' may reduce an employer's long-term liability, it does have the immediate effect of moving an off-balance sheet liability onto the balance sheet,'' he said.

Lowman said there are further actuarial issues for employers to consider, including:

■ the basis for the withdrawal liability calculations (e.g., discount rate);

■ how long the ability to change withdrawal liability methods will be open and whether employers can make the change when the plan is better funded but based on discount rates higher than settlement rates (annuity purchase rates);

■ whether there will there be pressure to lower the contribution rate or raise the benefit rate if lots of employers make the change; and

■ whether employers in the two pools will demand separate treatment for more than just withdrawal liability.

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