Withdrawal Liability Interest Rate Assumptions

Anthony Cacace
Partner
Proskauer Rose LLP
Eleven Times Square
New York, NY 10036
Tel: 212.969.3639

Jason Russell
Senior Vice President and Actuary
Segal
1800 M Street NW, Suite 900 S
Washington, DC 20036
Tel: 202.833.6407

Proskauer

Segal

September 17, 2022

Today's Agenda

- Background
- Recent Court Decisions
- PBGC Rulemaking Authority
- Continued Discussion

Background

Proskauer Segal

Withdrawal Liability

- Established in 1980 with Multiemployer Pension Plan Amendments Act (MPPAA)
- Plans charge employers **withdrawal liability** upon complete or partial withdrawal
- Represents employer’s share of plan's **unfunded vested benefits** (UVB)
  - UVB determined annually by plan’s actuary
  - Equal to shortfall, if any, between plan assets and value of vested benefits
  - Measured based on **actuarial assumptions** and methods
- UVB allocated under one of a few **allocation methods**, chosen by the plan
- Withdrawal liability paid according to a **payment schedule**, defined in statute

Our focus today will be on actuarial assumptions – specifically, the interest rate.

Actuarial Assumptions for Withdrawal Liability

ERISA Section 4213(a) – Actuarial Assumptions

The **corporation may prescribe by regulation** actuarial assumptions which may be used by a plan actuary in determining the unfunded vested benefits of a plan for purposes of determining an employer's withdrawal liability under this part. Withdrawal liability under this part shall be determined by each plan on the basis of—

(1) actuarial assumptions and methods which, **in the aggregate**, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, **in combination**, offer the **actuary's best estimate** of anticipated experience under the plan, or

(2) actuarial assumptions and methods set forth in the corporation's regulations for purposes of determining an employer's withdrawal liability.

Actuarial Assumptions for Minimum Funding

ERISA Section 431(c)(3) – Actuarial Assumptions Must Be Reasonable

For purposes of this section, all costs, liabilities, rates of interest, and other factors under the plan shall be determined on the basis of actuarial assumptions and methods—

(A) **each of which** is reasonable (taking into account the experience of the plan and reasonable expectations), and

(B) which, **in combination**, offer the **actuary's best estimate** of anticipated experience under the plan.

Prior to the Pension Protection Act of 2006 (PPA), the standard was the same as for withdrawal liability: reasonable **in the aggregate**.

Actuarial Standard of Practice (ASOP) No. 27

“Selection of Economic Assumptions for Measuring Pension Obligations”

- Applies to selection of discount rates and investment return assumptions
- A **reasonable** assumption must:
  - Be appropriate for the **purpose of the measurement**
  - Reflect the actuary’s **professional judgement**
  - Take into account **current and historical data**
  - Reflect the actuary's **estimate of future experience**
  - Be expected to have **no significant bias**

“An actuary measuring a plan’s present value of benefits on a defeasance or settlement basis may use a discount rate implicit in annuity prices or other defeasance or settlement options.”

Actuarial Interest Assumption: Three Approaches

Funding	Settlement	Something Else
• Interest rate is based on expected return on plan assets • Generally the same (or similar) as for minimum funding purposes	• Interest rate is based on settlement (annuity purchase) rates • Common proxy: PBGC interest rates for plan terminations	• Could be a blend of expected return on plan assets and settlement rates • Example: “Segal Blend” • Could also include a margin for adverse experience
• No implied **risk transfer** • New employers will replace withdrawing employers	• Full **risk transfer** • Employer must effectively settle UVB at annuity rates	• Partial **risk transfer** • Somewhere in between the two extremes

These are common approaches to setting actuarial interest rate assumptions.
Other approaches may also be reasonable.

Example: Funding, Settlement, Segal Blend

	Funding	Settlement	Segal Blend
1. Market Value of Assets	**1,000**	**1,000**	**1,000**
2. Present Value of Vested Benefits			
a. Funding Basis	**1,200**	N/A	1,200
b. PBGC Termination Basis	N/A	**1,600**	1,600
3. Blending Factor (1. / 2.b.)	N/A	N/A	**0.625**
4. Blended PV of Vested Benefits	N/A	N/A	**1,450**
5. PV of Vested Benefits for WL Purposes	**1,200**	**1,600**	**1,450**
6. Unfunded Vested Benefits (UVB)	**200**	**600**	**450**

Illustrative example: specifics will vary based on plan characteristics, interest rates, and other factors.

Adjustments to Withdrawal Liability

- De minimis credit
- Partial withdrawal
- 20-year payment cap

Impact of 20-Year Payment Cap

	Funding	Settlement	Segal Blend
1. Unfunded Vested Benefits (UVB)	200	600	450
2. PV of 20 Years of Payments	400	400	400
3. Shortfall (1. - 2.)	**N/A**	**200**	**50**

With low PBGC interest rates, many plans that use settlement or blended withdrawal liability assumptions have employers capped at 20 years of payments.

Recent Court Cases

Proskauer

Recent Court Cases

Pre-2018 Disputes	At least 15 court decisions and arbitrations Many involving **Segal Blend** Plan actuary assumptions upheld
New York Times	*New York Times v. Newspaper and Mail Deliverers Pension Fund* **Segal Blend** disputed, rejected, appealed, settled before decision
Manhattan Ford	*Manhattan Ford Lincoln v. UAW Local 259 Pension Fund* **Segal Blend** disputed, upheld
Interboro Fuel Corp.	*Interboro Fuel Corp v. Local 553 Pension Fund* **Segal Blend** disputed, upheld
Sofco Erectors Sixth Circuit	*Sofco Erectors Inc. vs. Ohio Operating Engineers Pension Fund* **Segal Blend** disputed, rejected
Energy West Mining DC Circuit	*UMWA 1974 Pension Plan v. Energy West Mining Company* **Termination assumptions** disputed, rejected

Sofco Erectors

- Simple Factual Background:
  - Employer (“Sofco”) was assessed approximately $1 million in withdrawal liability by the Pension Fund
  - Fund’s actuary used a 7.25% rate for minimum funding, but used the Segal-Blend for withdrawal liability
  - Sofco challenged the discount rate as improper
- Procedural Background:
  - Arbitrator granted summary judgment in the Fund’s favor, confirming use of discount rate
  - District court affirmed in part, but reversed with respect to the discount rate issue, holding that although the discount rate for withdrawal liability “need not always be the same as that used for minimum funding purposes,” it was not unreasonable here because it was not the actuary’s “best estimate of the anticipated experience under the plan”

Sofco Erectors *Continued*

6th Circuit Court of Appeals Holding (*15 F.4th 407 (6th Cir. 2021)*)

– Affirmed in part, reversed in part, vacated in part and remanded

– The “Segal Blend” approach to valuing a multiemployer pension fund’s UVBs for withdrawal liability purposes violated ERISA

Sofco Erectors *Continued*

- 6th Circuit Court of Appeals Reasoning:
  - The PBGC rates are used to determine the present value of future liabilities for plans that are terminated by a "mass withdrawal"
    - In a mass withdrawal, the plan must purchase annuities to cover promised benefits unless plan assets can be distributed "in full satisfaction" of all covered benefits
  - Using the Segal Blend here violates the statute because the resulting discount rate is not "the actuary's best estimate of anticipated experience under the plan"
    - The PBGC rates dilute the actuary's best estimate with rates on investments the plan might never buy; not tailored to "the unique characteristics of the plan"
    - In deposition testimony, the actuary justified the rate used by considering a hypothetical mass withdrawal (which was not occurring), rather than the "anticipated experience under the plan"
  - Actuaries can be conservative, but factoring in a discount for conservatism <u>after</u> the actuary has arrived at his best estimate of anticipated experience is contrary to the statute

Energy West Mining

- Simple Factual Background:
  - Energy West (“EW”) withdrew from UMWA 1974 Pension Plan (the “Fund”) in 2015
  - Fund was projected to become insolvent as early as 2022 at the time of the withdrawal
  - In determining UVB, Fund’s actuary adopted a risk-free discount rate (between 2.71-2.78%), while Fund’s historic performance was 7.5%. This selection increased EW’s withdrawal liability by approximately $75 million
- Procedural Background:
  - Arbitrator upheld Fund’s assessment with respect to discount rate
  - District court granted summary judgment in favor of the Fund, holding that ERISA requires that the actuary must independently calculate withdrawal liability and the law did not impose any substantive requirements on assumptions

Energy West Mining *Continued*

- D.C. Circuit Court of Appeals Holding (39 F.4th 730 (D.C. Cir. 2022)):
  - Reversed
  - The Fund actuary's choice of a risk-free rate violated the MPPAA's command to use assumptions that are “the actuary's best estimate of anticipated experience under the plan”

Energy West Mining *Continued*

- D.C. Circuit Court of Appeals Reasoning:
  - The requirement that the actuary give his "best estimate of anticipated experience under the plan" is both **procedural**, in that the actuary must make the assumption; *and* **substantive**, in that the assumption must be reasonable and reflect the characteristics of the plan
    - Measure of reasonableness is based on distance from minimum funding rate
    - Measure of reflection of the characteristics of the plan is tying discount rate to anticipated investment experience due to allocation of investment portfolio
  - While the assumptions used for minimum funding and withdrawal liability must be similar, they need not be identical
    - There is an "acceptable range," as numerous circuits have held
      - a difference of 500 basis points (5%), as seen here, is likely too large
    - For minimum funding, actuaries must use assumptions "**each of which is reasonable**"
    - For withdrawal liability, assumptions must be reasonable "**in the aggregate**," so one unreasonable assumption may offset another, leading to an overall reasonable withdrawal liability calculation

PBGC Rulemaking Authority

Proskauer

PBGC Rulemaking Authority

- In Fall of 2021, PBGC announced its intent to propose regulations governing the assumptions and methods actuaries may use when calculating withdrawal liability
- Authorized by MPPAA, 29 U.S.C. 1393 & 29 U.S.C. 1302(b)(3)
  - 29 U.S.C. 1393(a): "The corporation may prescribe by regulation actuarial assumptions which may be used by a plan actuary in determining the unfunded vested benefits of a plan for purposes of determining an employer's withdrawal liability under this part"
  - 29 U.S.C. 1302(b)(3): "[The corporation has the power] to adopt, amend, and repeal, by the board of directors, bylaws, rules, and regulations relating to the conduct of its business and the exercise of all other rights and powers granted to it by this chapter and such other bylaws, rules, and regulations as may be necessary to carry out the purposes of this subchapter"
- On August 22, 2022, PBGC submitted proposed regulations for review by the Office of Management and Budget (OMB)

Continued Discussion

Proskauer

Continued Discussion

- *Metz* Decision
- Best Practices

Proskauer