Defined Benefit Pension Plan Mergers

Protecting Vested Pension Benefits from Plan Asset Transfers

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Executive Summary

Unlike the shareholders of public companies, who willingly accept the risks of corporate financial performance, the tens of millions of employees and retirees who participate in defined benefit pension plans sponsored by those same companies are supposed to be protected from the financial risks associated with business decisions such as corporate mergers and acquisitions. Earned benefits are protected by ERISA under rules intended to ensure that pension plan funding levels are sufficient to minimize the risk of a distress termination and the permanent loss of vested benefits that often occurs as a result.

Distress terminations are initiated by companies declaring bankruptcy or in some cases by the Pension Benefit Guarantee Corporation (PBGC) with the approval of a federal court. If a company declaring bankruptcy remains in business, it must demonstrate it can no longer fund its pension plan as part of a successful restructuring. A key element in making a decision to approve a distress termination is the level of plan funding, calculated as the fair market value of plan assets minus projected liabilities. When assets fall substantially below the level needed to sustain the payment of benefits, a plan is at far greater risk of a distress termination. Many workers and retirees learn only *after* the PBGC takes over a plan that a distress termination can leave them with benefits that are permanently reduced by 30% or more.

This issue brief focuses on a looming new form of financial engineering: the merging of pension plans as part of a strategy to benefit the plan sponsor by combining plans with very different levels of plan assets and liabilities. Depending on the circumstances, merging pension plans can be beneficial to plan sponsors and harmless to participants, such as when companies merge two well-funded plans to reduce administrative costs. However, defined-benefit plan mergers can also be very damaging to the vested rights of plan participants.

For example, when a well-funded plan is merged with a very under-funded plan, retirees and other plan participants in the previously well-funded plan can be put at risk. In situations where the plan sponsor effectively uses the plan merger to transfer assets from the well-funded plan to fill a hole in the under-funded plan, whether to reduce the company's total minimum required contributions or for other reasons, this practice amounts to the equivalent of a "reversion" of plan assets that weakens the retirement security of the retirees and participants in the previously well-funded plan.

Because the agencies that regulate pension plans do not monitor or review intra-firm mergers, it is unknown how many plan mergers have had a detrimental impact on retiree income security.

PBGC not only lacks advance notice of intra-firm mergers, the agency has waived the requirement for post-event reporting of plan mergers despite the fact that Congress in ERISA Section 1343(c)(8) specified that *all* plan mergers are reportable events and that ERISA Section 414(l) explicitly mandates that the participants and beneficiaries in the higher-funded plan be held harmless if PBGC takes the merged plan over after a distress termination.

What is clear is that plan sponsors have both the ability and incentive to engineer plan mergers in ways that may reduce costs for the company, but increase the risk of permanent benefit losses for retirees. NRLN proposes the following changes:

- **Advance Notice of Reportable Events: All mergers of two or more qualified plans should be reportable events, as ERISA originally required, and included among the transactions that require an Advance Notice of Reportable Events to the PBGC.**

- **Pre-Approval Process: Plan mergers should be reviewed by the PBGC and IRS and challenged as appropriate.** Reasons for challenging or denying a plan merger should include: (i) if a plan merger has the effect of substantially reducing the plan sponsor's overall minimum funding requirement; or (ii) if the merged plan's Funding Target Attainment Percentage (FTAP) imposes substantial risk on participants in the higher-funded plan (e.g., the FTAP falls below 80%).

- **A Plan Merger Should Not Reduce the Minimum Funding Contribution During PBGC's 5-Year Hold Harmless Protection Period:** Although plan mergers can improve administrative efficiency, some are done to further reduce the company's minimum required contribution even more than permitted under the MAP-21 "funding relief" provisions adopted by Congress and extended through at least 2020. A plan merger that substantially reduces funding for its plans overall raises the risk of a distress termination and harms retirees.

  NRLN proposes that for a period of five years following a plan merger, the plan sponsor's minimum annual funding contribution should be no less than what the company would have contributed if the plans had not merged. This change tracks and reinforces the PBGC's 5-year "hold harmless" protection. Pursuant to ERISA Section 414(l), if a merged plan is terminated, the PBGC applies its Priority Category allocation of benefits in a manner that ensures participants in the higher-funded plan (prior to the merger) do not lose vested benefits that would have been funded based upon the assets and funding level of the plan at the time of the merger. The PBGC limits this 'hold harmless' protection to a 5-year window following the plan merger.

- **Scrutiny in Distress Terminations: For a period of five years after a qualified plan merger, the PBGC should be required to oppose any proposed distress termination of the merged plan unless the plan sponsor can establish, to the satisfaction of the agency or a court in bankruptcy, that a distress termination would have been justified at the pre-merger funding level.**

The whitepaper researched and written by the American Retirees Education Foundation is the source of information for this Executive Summary. The AREF expands the research and education reach of the NRLN.

For a copy of the whitepaper on this subject, contact Alyson Parker, at 831-545-6792 or executivedirector@nrln.org