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LEGISLATIVE NETWORK

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Defined Benefit Pension Plan Mergers

Protecting Vested Pension Benefits from Plan Asset Transfers

Executive Summary

Unlike the shareholders of public companies, who willingly accept the risks of corporate financial performance and market ups and downs for a profit (supplemental retirement income), nearly 40 million U.S. retirees depend upon company fiduciaries and the rules of ERISA to protect their accrued pension benefits since they do not own their assets. Company plan fiduciaries who do not adequately fund pension plans shift financial risks associated with business decisions such as corporate mergers and acquisitions.

Bankruptcies can and do lead to distress plan terminations and the permanent loss of vested benefits - a looming danger for the underfunded plans. Unless the law (ERISA) is changed by Congress, we will continue to see Congress approve funding holidays to achieve tax revenue objectives, companies will continue to meet minimum funding requirements only to preserve cash to support foreign investments and slowly but surely defined benefit pension plans will weaken and continue to fail. Most companies that seek bankruptcy protection reengineer their business and financial structures and live on but terminated defined benefit pension plans don't.

ERISA Funding Rules Do Not Protect Against Underfunding and Plan Terminations

A key factor in the decision to approve a distress termination is the level of plan funding, calculated as the market value of plan assets minus projected liabilities. ERISA technically requires plans to fund 100% of accrued liabilities, but no action is taken until a plan falls below the 80% level, which triggers a freeze on plan amendments to enhance benefits (not terribly likely in any case). At 70% funding plans are more restricted. However, in any case the only true funding requirement is the Minimum Funding Requirement. The Delta Air Lines management plan sponsor meets the Minimum Funding Requirement each year, but the plan has remained funded below 50% for years. ERISA protects accrued pension benefits but what is the value of an unfunded benefit that could be terminated due to underfunding?

The New Plan Asset Funding Concern – Plan Mergers

There is a new form of financial reengineering, 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 and other costs. However, defined-benefit plan mergers can also be very damaging to the vested rights of plan participants.

No Public Records

There are no public records to show how many plan mergers have had a detrimental impact on retiree income security. What is clear is that plan sponsors have both the ability and incentive to engineer plan mergers in ways that may reduce costs and risks for the company, but increase the risk of permanent benefit losses for retirees. The NRLN believes that a merger or combination of qualified defined benefit plans should be scrutinized for its impact on retiree pension benefits. Participants in a merged plan who experience a substantial reduction in current funding levels as a result of the plan merger should be exempt from any adverse impact from a post-merger distress termination.

Plan sponsors who wish to merge (combine) two or more plans should be required to submit such merger proposals to the PBGC, DOL and IRS for approval.

The PBGC should ensure the full amount of benefits that such participants accrued while participants in their former plans. After expiration of a five-year period, the PBGC in applying its Priority Category allocation of benefits, should guarantee that retirees and participants do not lose any vested benefits.

Current Examples that Demonstrate a Need for Legislative Action

Nokia is currently in the process of acquiring Alcatel-Lucent. Participants in the Alcatel-Lucent pension plan are rightly concerned about what might happen to their pension plan security should Nokia U.S. and Alcatel-Lucent U.S. plans and possibly plans from other Nokia corporate acquisitions be merged.

Fiat Chrysler recently combined two U.S. management pension plans and the successor combined plan was underfunded whereas participants in the better funded plan lost 6% of its funding level because of the merger.

CenturyLink (CTL) merged three dissimilar plans and the post-merger combination of the three pension plans has effectively transferred 81,000 former Qwest plan participants from a very well-funded plan to one that would be at risk of a distress termination should the plan sponsor declare bankruptcy. CenturyLink bought the Embarq and Qwest corporations and then merged its Embarq Retirement Pension Plan and Qwest Pension Plan into the CenturyLink Retirement plan and relabeled these three the CenturyLink Combined Pension Plan as of December 31, 2014*. CTL disclosed in the CTL Combined plan 2015 Annual Funding Notice (AFN) that the funding shortfall of the Qwest plan worsened from $721 billion to $1.032 million and that the CTL and Embarq plans combined funding shortfall worsened by $1.267 million.

In plan year 2013, the Qwest plan reported a funding level of 91%. However, when CenturyLink merged the Qwest plan with the Embarq and CenturyLink Plans (funded at 76.33% and 74.43% respectively), the combined plan was reported at 84.1% – a dangerous drop in funding relative to the Qwest plan's prior funding level. At the end of the 2013 plan year, the Qwest plan funding shortfall (2013 plan year Annual Funding Notice) was reported at $765,710. The 2014 Combined AFN reported a plan ending funding shortfall of $2,269,783.

Re-engineering the merger of these plans obscures the true funding levels of all three plans and exposes the 81,000 Qwest plan participants to a substantially greater risk of a plan termination.

Needed Changes to Regulations and /or Statutes Governing Plan Mergers

ERISA and IRS Sec 420 are intended to ensure full funding and to protect against asset reversions. ERISA generally deters transfers of assets even when a plan is in surplus. Where a plan is funded at or above 120% of the required funding level (125% for a collectively bargained plan), surplus in excess of that level may be transferred to a Section 420 account only where it is reserved exclusively to pay for retiree health care or life insurance benefits.

While Section 420 allows plan sponsors to transfer surplus pension assets to offset the cost of retiree health benefits, ERISA does not allow the transfer of plan assets to pay for the health care costs of active employees or other operating costs. Combining two or more plans' assets and liabilities should not increase the risk of a distress termination and the consequent loss of vested benefits for a substantial number of the retirees and other participants in the previously well-funded plan that ends up under-funded as a result of the combination.

Rules for Plan Participants Whose Plans are Terminated (Distress Terminations)

IRS Code 414L, Section E. ostensibly protects participants of well-funded plans that are merged with underfunded plans when a combined plan is terminated within five (5) years, but only if the loss of assets exceeds a minimum limit. When the limit is exceeded, former participants of higher funded plans merged with others receive priority allocation of PC3 benefits. This does not stipulate that PBGC assets must offer a make-whole restoration of pre-merger benefits.

This protection is weak and if enforced would provide little protection. It is very clear that this protection is not intended to protect plan participants from a distress termination.

NRLN Proposed Changes to ERISA:

- **Pre-Approval Process: Plan sponsors should be required to submit the proposed merger (combination) of two or more qualified plans to the PBGC, DOL and IRS for review and approval. Avoidance of funding of underfunded plans, as well as any substantial reduction in the funding level of a merged plan, shall be a reason for denial.**

- **Distress Termination: For a period of at least 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.**

- **Hold Harmless Provision: For a period of at least five years following a qualified plan merger, the PBGC should ensure that, in applying its Priority Category allocation of benefits, retirees and other plan participants do not lose any vested benefit that would have been funded based upon the pre-merger asset and funding level of their plan, or the current termination funding level of their plan, whichever is higher. PBGC insurance should guarantee the priority claims of participants who would lose vested benefits due to the merger's reduction of plan funding levels, if necessary.**

For a copy of an NRLN position paper on this subject, contact Alyson Parker at 813-545-6792 or executivedirector@nrln.org