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Coronavirus Crisis Workforce Reduction Can Adversely Affect Retirement Programs

The coronavirus pandemic continues to ripple across the country and many organizations face several unprecedented, difficult decisions surrounding their workforce and the use of cash. While payroll-reducing strategies may be necessary during this time of substandard revenue, they may also present other costs or hurdles in the company's pension, retiree medical, and retiree life insurance programs. Significantly changing employee demographics can trigger unexpected accounting, cash flow, and compliance issues that could be an unwelcome surprise given current market conditions.

State mandated stay-at-home orders not only reduce the ability for consumers to purchase, but also the need for employees to produce. For many industries, this means downsizing workforces and payroll at record levels via layoffs, furloughs, reductions in force, and salary cuts. However, in this time where management decisions are focused on the best positioning of their organization from "crisis" to "rebound" mode, it is important that pension and retirement programs are not placed on the back burner.

Identify and Prepare for Potential Consequences

A proactive analysis of an organization's workforce reduction program, as well as the group of employees impacted, may help identify and prepare for the impact of some of these potential unintentional consequences:

Curtailment Accounting Under U.S. GAAP

Curtailment accounting may be initiated when more than 5-10% of the plan's active participants are impacted by a workforce reduction event such as layoffs or forced termination, or a reduction or elimination of future benefit accruals. The curtailment impact is an immediate recognition of a portion of unrecognized prior service costs and could also prompt an interim re-measurement at the time of the event, likely unfavorable given the current market environment. Curtailment accounting can increase the "below the line" expense for accounting for pension, retiree medical, and retiree life insurance plans under U.S. GAAP.

Settlement Accounting Under U.S. GAAP and Cash Concerns for Pension Plans Offering Lump Sums

Settlement accounting is set into motion when lump sum payouts exceed the service cost and interest cost components of net periodic pension cost during the fiscal year. This may be increasingly likely as laid off participants may access their pension benefits for their own financial security. The settlement impact is an immediate recognition of unrecognized gains and losses, and similar to curtailments, could also cause an interim re-measurement at the time of the event.

In addition, while payroll reducing strategies may be advantageous for cutting current expenses, pension plans that offer lump sums upon termination could end up in a situation where the plan requires more cash in the future. Paying an increased number of lump sums to participants could force the pension plan to raise cash by selling equities at a time when the market is significantly depressed. Selling equity at market lows may inhibit the pension plan's ability to recover in the long term.

Benefit Enhancements and Plant Shutdown Liability under PBGC and ERISA

Benefit enhancements and plan shutdown liability may be triggered when either a facility closure impacts more than 15% of the plan sponsor's active participants benefitting in any pension or defined contribution plan; or if the pension plan document provides for special shutdown benefits in any size closure. Special, enhanced shutdown benefits that can increase pension plan liability and plan costs may be required to protect employees close to retirement if defined in the plan document. In addition, the *Pension Benefit Guaranty Corporation (PBGC)* may require special reporting and accelerated cash contributions under *ERISA 4062* for some underfunded pension plans. The PBGC also may require a special report under ERISA 4043 if the number of active participants is significantly reduced for any reason.

Vesting Enhancements under IRS Partial Pension Plan Termination

A partial pension plan termination may occur when more than 10-20% of the plan's active participants are impacted by closing a facility or division, or from any higher turnover due to economic factors. Partial pension plan termination requires the plan sponsor to grant immediate vesting eligibility or face Internal Revenue Service (IRS) disqualification in the pension plan. This is ultimately an IRS decision based on facts and circumstances and might be avoided if the reduction is structured to furlough (not typically a formal separation) rather than permanently terminate employees.

Increased Liability and Cash Requirements for Unfunded Retiree Medical Plans

Eliminating participants who are retirement eligible can lead to a spike in retiree medical claims costs and liabilities. Unfunded retiree medical plans "pay as you go" and do not have back-up trust assets to use toward claims in the event more participants begin retiree medical plan benefits sooner than expected. Retiree medical plans with early eligibility may be responsible for benefits over a much longer period than expected at a time when rates charged by insurers may also be increasing. Together, plan sponsors may see increased claim costs in 2021, as well as higher liability and net periodic benefit costs in fiscal 2021.

IRS Compliance Concerns Related to Passing Pension Plan Non-discrimination Testing

There is a likelihood for increased difficulty in obtaining favorable non-discrimination testing (NDT) results when there is a significant change in the demographics of the plan's active employees. For example, NDT results will be less favorable when non-highly compensated employees (NHCEs) are forced to terminate at higher rates than highly compensated employees (HCEs) and also when salaries for NHCEs are reduced at higher levels than HCEs. Alternatively, workforce reductions impacting HCEs at higher rates could improve testing results.

Violation of Union Agreements and Debt Covenants

While not tied exclusively to workforce reductions, any decision that deviates from normal practice has a potential to violate established agreements with union contracts and debt covenants. Keep in mind, relief permitted by the *Coronavirus Aid, Relief, and Economic Security Act (CARES Act)* may not be permitted under current arrangements.

Minimum or Variable Interest Credit Rates for Cash Balance Plans

While interest crediting rates have already been set for most cash balance plans with calendar plan years, if low interest rates persist it could mean a significant drop in the crediting rate for 2021, possibly requiring the minimum interest crediting rate to apply. In addition, plans using variable interest crediting rates may see negative returns, making non-discrimination testing more difficult.

Seek Guidance

The bottom line is this: the coronavirus crisis continues to evolve and any workforce strategy decision should be pursued with guidance from your actuary, auditor, or legal counsel. Early analysis may help your company prepare for retirement program concerns that may arise from implementation of the selected cost-saving payroll strategy. Contact your Findley consultant to discuss any workforce reduction program you may be considering to ensure all relevant issues are addressed.

Questions? For more information, contact the Findley consultant you normally work with, or contact Debbie Sichko at *debbie.sichko@findley.com*, or *216.875.1930*.