Necessity Breeds Innovation: How Composite Plans Can Bring Sustainability to the Multiemployer Pension System

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Executive Summary

- *After decades of success, multiemployer pension plans face a crisis in which more than a million participants are at risk of losing their benefits.*
- *The current funding crisis occurred because the benefits in these plans are fixed and guaranteed, while the resources backing those benefits are uncertain and limited.*
- *Composite plans are a proposed new type of retirement plan that will provide greater stability and sustainability than current plans, while not making promises that plans are unable to keep.*
- *A detailed case study illustrates how the key features of composite plans, including a conservative funding target and the ability to adopt modest benefit reductions early in response to a funding shortfall, can provide greater long-term benefit security than current pension plans.*

Since the passage of the Employee Retirement Income Security Act in 1974, multiemployer pension plans have paid hundreds of billions of dollars of benefits to retired workers from a wide range of blue-collar industries. It would be almost impossible to overstate the positive impact these plans have had on the men and women who participate in them. Millions of people have enjoyed comfortable and dignified retirements that would have been beyond their reach had it not been for the steady and reliable pension checks that these plans provide.

After decades of success, the multiemployer system faces an existential crisis. More than 10% of plans are approaching the point of collapse, and over one million participants are in danger of losing their benefits nearly in their entirety. For participants who have made a lifetime of financial plans that hinge on receiving the pensions they were promised, it is devastating to learn that those pensions may disappear. While policymakers argue over how to address this crisis, lives hang in the balance.

The multiemployer funding crisis can be traced back to the 2008 collapse of the housing market and the Great Recession that followed. This is an explanation not an excuse, as like all financial institutions, multiemployer pension plans need to be resilient enough to withstand the severe economic turbulences that have always, and will always, occur periodically. And while the majority of multiemployer plans are currently on pace to satisfy all of their benefit promises, they remain exposed to the same long-term risks that caused the downfall of the 100+ plans that will be insolvent unless Congress steps in with assistance.

With the nation in the grips of the COVID-19 pandemic that is crippling the economy, the next major economic downturn is upon us. Stakeholders in the multiemployer system are justifiably concerned that the pandemic will cause even more plans to fail, and are working with policymakers to craft relief measures. These are necessary steps, but it is equally necessary to consider the factors that have made multiemployer plans vulnerable to failure, and to look for ways to increase the stability and sustainability of the system for the future.

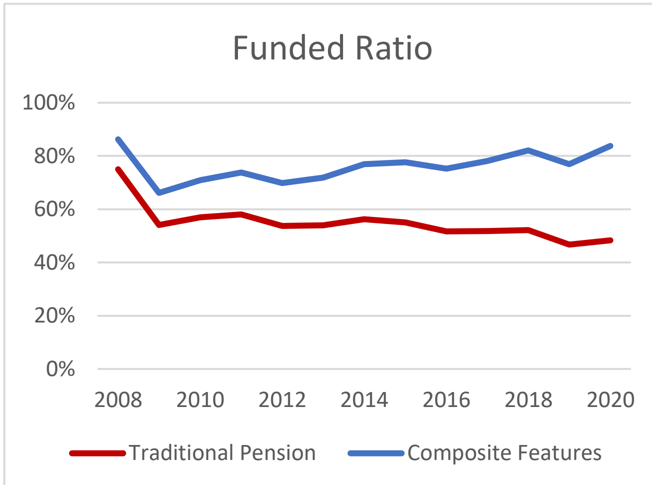
Federal law and the current funding rules look to the contributing employers as the ultimate guarantor of pension benefits. This approach was well-intentioned, but it has not led to the desired results. The financial risk of backstopping pension benefits has widely driven employers out of the system. Further, the ability of employers to absorb the cost of unfunded pension liabilities will always be limited, creating a meaningful risk that plans will be unable to fulfill their benefit promises.

The multiemployer system needs new ideas and creative thinking in order to meet the needs of future generations of workers and retirees. The composite plan model is an innovative approach to providing multiemployer pension benefits that was developed by a commission of roughly 40 labor and management organizations. Composite plans would be strictly voluntary. Plan sponsors who believe the new model meets their needs better than current plan design options would be able to transition to a composite plan. Other sponsors may choose to remain in the current system.

Composite plans provide benefit security through conservative funding principles and early corrective action when underfunding develops. Employer costs are highly predictable in much the same manner as 401(k) plans, so that contributing to composite plans will never threaten the viability of their businesses. During periods of severe economic stress and only as a last resort, it is possible that a composite plan may need to reduce participant benefits in order to preserve the solvency of the plan. When necessary, this step will be taken long before plans become in danger of failure, ensuring that the massive benefit cuts currently facing traditional pension plans never occur in composite plans.

As opposed to 401(k) plans that typically pay lump sums, composite plans pay all benefits as lifetime annuities, so participants do not need to worry about outliving their accounts and being left with no further income. Composite plans will be highly transparent by always making participants aware that a significant decline in the financial markets could necessitate reduced benefit levels in order to preserve the long-term sustainability of the plan. Participants are also exposed to financial risk in the current multiemployer system, but the risk is not well-communicated and the mechanisms for responding to adverse events are inadequate.

A case study model demonstrated the effectiveness of the benefit security features of composite plans compared to traditional pension plans. The study looked at a traditional pension plan that entered critical and declining status following the 2008 market crash, and then modeled how the experience of the plan would have been different if a more conservative funding target had resulted in a 15% higher asset value at the beginning of 2008 and if the trustees had been allowed to adopt a modest 5% benefit reduction following the 2008 declines.



The chart at right shows the powerful effect these two factors had on the long-term health of the plan. The combination of the higher funding target with the early application of a small benefit cut put the plan on a path towards recovery. In contrast, the traditional pension plan was unable to recover from the losses it sustained and found itself headed towards insolvency. The traditional pension plan could have sought to cut benefits using the provisions of the Multiemployer Pension Relief Act of 2014, but the delayed response and lower initial funding level would have necessitated benefit cuts far in excess of the 5% reductions that were sufficient in the scenario with the composite plan benefit security features.

The theme of composite plans is simple. When establishing benefit and contribution levels, build in a margin to guard against the possibility of bad experience. And in the rare instances where despite this margin, the plan cannot be returned to financial health by adjusting contribution rates and future benefit accruals, adopt reductions to past benefits immediately. While reducing past benefits is never easy, taking this step at the first sign of a long-term imbalance will prevent plans from ever facing the dire funding crisis that currently plagues the multiemployer pension system.

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Background

It is no secret that traditional private-sector pension plans are facing hard times. Among non-unionized workforces, there has been a dramatic migration away from traditional defined benefit plans and toward defined contribution plans such as 401(k) plans. A report from Willis Towers Watson found that as recently as 1998, 59% of Fortune 500 companies offered a defined benefit pension plan to newly hired employees, while in 2017 only 16% did so.[1] The 2017 report of the PBGC Participant and Plan Sponsor Advocate concluded that "while plan sponsors do understand the value that defined benefit plans bring to an organization", reducing financial risk was a significant factor in the trend away from ongoing defined benefit plan sponsorship.

Multiemployer pension plans, all of which cover collectively bargained workforces, have largely remained with defined benefit designs, despite the challenges presented by economic declines and regulatory shifts. However, the number of active employees covered by the system has steadily declined over the past several decades, with data published by the Pension Benefit Guaranty Corporation showing a 37% decline in this population between 1980 and 2016.[2] Consistent with the drop in the population of active employees, most plans have seen large reductions in the number of contributing employers. More significantly, between 10% and 15% of multiemployer plans, covering well over one million participants, are projected to fail in the coming 20 years.[3] Only relief from the federal government will prevent retirees in these plans from losing their pensions in their entirety. Despite the best of intentions, the unfortunate reality is that the multiemployer pension system has not achieved the prerequisites needed for sustained success.

Retirement plans will only achieve long-term success if employers are willing to participate in them and if they are consistently able to live up to what they promise. Federal law obligates pension plans to make benefit promises to participants, while relying on employers to pay for the funding shortfalls produced by investment losses or economic downturns. As a result, companies that do not participate in the system are unwilling to join, and many that do contribute are looking for a way out.

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[1] https://www.willistowerswatson.com/en-US/Insights/2018/02/evolution-of-retirement-plans-in-fortune-500-companies

[2] See tables M-5 and M-7 from PBGC's 2017 Pension Insurance Data Tables.

[3] Based on Congressional Research Service report *Multiemployer Defined Benefit (DB) Pension Plans: A Primer* and analysis prepared by Cheiron Inc. (see December 17, 2019 press release).

The current state of multiemployer plans has negatively impacted active participants in addition to contributing employers. On top of requiring increased contributions from employers, many plans have drastically cut benefit accruals for active participants in order to improve funding levels for benefits promised to current retirees. Younger workers in these plans are earning significantly lower retirement benefits than prior generations earned, while increased contribution requirements adversely affect their take-home wages. This inequity puts additional pressure on a system that needs the participation and support of younger workers—in addition to their employers—to sustain the benefits promised to retirees.

Multiemployer plans need to embrace new ideas and approaches in order to meet the needs of employers and employees for generations to come, and new federal law is needed to facilitate these ideas and approaches. The composite plan model was developed as a legislative proposal for this reason. A composite plan would be an optional plan design that would serve as an alternative to both traditional pension plans and defined contribution plans such as 401(k) plans. As discussed more fully below, the composite model protects employers from financial risk, while using conservative funding principles and benefits that can be adjusted when necessary to ensure that participants are never at risk for catastrophic benefit losses.

Like all institutions, multiemployer pension plans are trying to determine how the COVID-19 pandemic will affect them. Without doubt, the current funding challenges will get worse. More plans will be on track to be insolvent, and other plans will need to take additional funding improvement measures on top of what they have already done. Some employers struggling with a very difficult business climate will not be able to make up for the investment losses plans have experienced, and retirees will rightfully worry that their pension checks may stop arriving.

The sustainability of a retirement system cannot be measured during easy times; Congressional policymakers need to consider how it reacts to difficult circumstances. A challenge like we are currently facing is an ideal time to evaluate the resiliency of both the current retirement system and potential new approaches. We do not know what the next crisis will look like, only that there will be a next crisis. Financial institutions must be stable enough to withstand whatever calamities come along, and the current crisis is an opportunity to evaluate their sustainability.

Employer Perspective on Traditional Multiemployer Plans – Cost Uncertainty

Employers contribute to multiemployer plans in accordance with collective bargaining agreements. These agreements typically specify an amount to be contributed per hour of work, though other units may be used. When plans become underfunded, employers can be forced to dramatically increase their contribution rates and can also be exposed to withdrawal liabilities that exceed the entire value of their businesses. Notably, the increased cost is not attributable to the benefits that active participants are earning for their service going forward. Rather, years of service that were worked in the past retroactively become more expensive, and the employers currently in the plan are obligated to come up with the shortfall.

Businesses face cost volatility from many sources, but the financial difficulties presented by multiemployer pension plans are unique. Consider a business that purchases a raw material. If the price goes up, the company is not obligated to pay the higher price on materials that it purchased in prior years, nor would it ever agree to such an arrangement. But that is exactly what happens when a multiemployer pension plan becomes underfunded. Further, in the manufacturing example the company might find alternative suppliers, change its manufacturing process, or migrate to more profitable operations. There are no similar options with underfunded multiemployer plans, as an attempt to cease contributing to the plan is likely to lead to a withdrawal liability assessment.

In effect, the employers contributing to multiemployer pension plans are providing insurance against the performance of the stock market. When the returns on plan assets fall short of expectations, the only way the plan can live up to its benefit promises is for the employers to make up for the shortfall. <u>The absurdity of this arrangement becomes clear when you consider that not only are the employers acting as insurers, they are providing a form of insurance that actual insurance companies are unwilling to offer.</u>

Participant Perspective on Traditional Multiemployer Plans - Benefit Insecurity

The benefits earned in traditional defined benefit multiemployer pension plans are promises. Plans describe their benefit levels as fixed dollar amounts, not targets that they hope to pay if everything goes well. Participants have viewed their benefits as amounts that they are guaranteed to receive. Federal law has generally supported these perceptions, only recently allowing any cuts to accrued benefits, and only in very narrow and dire circumstances.

Multiemployer pension plans have several resources on which to draw when meeting their benefit promises. Plans hold assets that are invested in diversified portfolios. Pension funding anticipates the returns those assets will earn in the future, typically at a rate of 7.5% per year in multiemployer plans. Employer contributions under collective bargaining agreements generate resources for paying benefits. When employers cease contributing, plans that are underfunded generally assess withdrawal liability.

All of the resources supporting multiemployer pension benefits share an important characteristic. They are uncertain. Assets can decline and a reasonable rate of expected investment return may not materialize.[4] Employer contribution rates cannot be increased beyond reasonable limits, and the employment level can diminish due to employer withdrawals, economic and regulatory shifts, or changes to the collective bargaining landscape. Statutory limitations and employer bankruptcies often leave plans unable to collect the full amounts of withdrawal liability assessments.

When you put it all together, you have benefits that are fixed and guaranteed supported by resources that are unpredictable and limited. This approach may work most of the time, especially before plans become mature with large retiree populations. But sooner or later, economic turbulence of one type or another will create funding shortfalls from which some plans will be unable to recover. That is exactly what has occurred in the multiemployer system, and without reform it is likely to happen again. The system is overdue for a new design model that is more resilient to adverse economic conditions.

An outcome is never guaranteed merely because someone says so. It is not words that makes a guarantee a reality, it is the resources that are needed to make the desired outcome happen. Despite the widespread perception, multiemployer pension benefits have never been guaranteed, because none of the resources backing them are substantially free from uncertainty. When those resources fall short, as is occurring right now in over 100 plans, basic arithmetic will require that benefits adjust to what plans can actually afford. This principle applies to the PBGC multiemployer insurance program as well, which is currently underfunded by more than $50 billion. <u>The fact is,</u>

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[4] A reasonable expectation represents the median value of anticipated future returns, meaning there is a 50% likelihood that returns will fall short of what is expected.

while they are never described as such, the benefits earned in multiemployer plans are, and always have been, variable benefits.

Overview of Composite Plans

Composite plans are a proposal for a new type of multiemployer retirement plan. They are a voluntary approach that plan sponsors could choose to use or not use depending on their unique needs and priorities. There are three core concepts that underlie the composite plan proposal:

- Do not make promises to retirees that plans may not be able to honor
- Protect employers from financial risk so they will be willing to participate in the system
- Provide participants with sustainable lifetime income

Composite plans operate in much the same manner as current defined benefit plans. Employers contribute in accordance with collective bargaining agreements. Employees earn benefits according to benefit accrual formulas. Trustees manage plan assets as fiduciaries, retain investment management professionals, and make decisions based on the best interests of participants. Actuaries measure the liabilities annually and calculate the current and projected funding levels.

The benefits payable from composite plans remain fixed as long as the plan has the resources to support them, but they can also vary as a last resort if it is necessary to ensure the solvency of the plan. Communications with participants are transparent and emphasize the expected nature of the benefits. The funding rules governing composite plans require conservative funding targets and early corrective action on the part of trustees, ensuring that any underfunding is addressed while it is still small and can be handled with relatively minor actions.

Employers contributing to composite plans are liable only for the contribution rates they have bargained with the union. Plans cannot force employers to contribute at higher levels, and there is no concept of withdrawal liability. The experience of the current pension system has shown that the bargaining parties will choose to dedicate additional resources to the plans when funding levels decline, as has occurred many times from the 1980's through today. But this experience has also shown that there are practical limits to how high contribution rates can be raised. Moreover, making employers legally liable for funding shortfalls will drive them out of the system while giving participants a false sense of security in the benefits they have been promised.

A significant difference between composite plans and traditional pension plans is in the funding target. In a composite plan the contributions must be calibrated to reach a funding level of 120% (i.e., the assets exceed the liabilities by 20%), versus only 100% in a traditional pension plan. Additionally, the funding rules for traditional pension plans focus on the current funded level, while the funding rules for composite plans focus on the projected funded ratio. <u>Conservatism and an emphasis on early corrective action based on long-term planning provide real benefit security to participants.</u>

The composite plan proposal also includes robust provisions to ensure that a plan sponsor that moves to a composite plan responsibly funds the legacy pension plan. The sponsor of a critical status plan is not permitted to adopt a composite plan, providing an additional incentive for improved funding levels. If an employer withdraws from a legacy plan, its employees are unable to earn any benefits in a composite plan, which provides assurance that the legacy plans will not be abandoned. If a legacy plan becomes seriously underfunded, up to 75% of the total contribution rate between the legacy and composite plans must be allocated to the legacy plan, making it impossible for the funding needs of the legacy plan to be neglected. The trustees of the legacy plan would continue to act in a fiduciary capacity and would be subject to legal action from participants and regulators if they allowed contributions that are necessary to fund the legacy plan to instead go to the composite plan.

Benefit Security in Composite Plans

Composite plans address the shortcomings of traditional pension plans that have become apparent in recent years. Employers cannot act as insurers against stock market losses, and it is unreasonable to expect them to do so. If there is a realistic possibility that a plan might someday be unable to fully pay a participant benefit, then it must transparently inform participants of this possibility and have a reasonable mechanism in place for adjusting benefits when necessary.

It is tempting to think that benefits in composite plans will be less secure than benefits in traditional pension plans. After all, the trustees of traditional plans are prohibited from reducing any accrued benefits until the plan is in dire financial condition, while the trustees of composite plans have this authority much earlier. A deeper analysis reveals the error of this thinking. There are more than one million participants in traditional multiemployer pension plans whose retirement benefits will be lost nearly in their entirety unless Congress steps in, which is nothing short of a catastrophe. Imagine if the trustees of these plans had the authority to return the plans to solvency through modest benefit cuts implemented as soon as it was clear the plan was headed in the wrong direction. No trustee would want to take this step, but certainly it is preferable to allowing the plan to fail and leaving participants with nothing. <u>Solutions are always less painful when problems are identified and dealt with as early as possible, even when it requires making difficult decisions.</u>

The security of a benefit is measured only by the resources supporting it. Ultimately a retirement plan can only pay the benefits that it can afford based on the available assets, and when those assets run out, benefits will stop. The benefit levels and contribution rates in composite plans must be established such that the assets are expected to cover 120% of the liabilities, and this fact alone makes the benefits in these plans far more secure than traditional pension plans. Further, employers will be far more willing to remain in these plans, even during difficult economic climates, because they are not exposed to withdrawal liabilities that could wipe out their businesses. And should these additional resources prove insufficient, early intervention will ensure that funding shortfalls are not allowed to fester and grow into the disaster that currently faces the multiemployer pension system.

Impact of COVID-19 Crisis

The current funding challenges in the multiemployer system can be traced directly to the 2008 financial crisis and the Great Recession that followed. For more than 100 multiemployer plans, the losses that occurred in the equity markets and the job losses that followed made it impossible for them to live up to their benefit promises. Over one million participants in these plans are in danger of losing their retirement benefits as a result.

The next crisis is upon us now in the form of the COVID-19 pandemic. The S&P 500 Index is down approximately 10% so far in 2020, and large segments of the economy are virtually shut down. Stakeholders in the multiemployer system are deeply concerned about what this will mean for multiemployer pension plans.

In a traditional defined benefit pension plan the federally mandated target is for plans to accumulate assets that are equal to the liabilities. In contrast, the contribution rates and benefit levels in a composite plan must be set such that the assets will accumulate to 120% of the liabilities. A participant in a traditional pension plan will need to hope that some combination of increased employer contributions and future stock market gains will be sufficient to make up for the losses that have occurred thus far in 2020. In a composite plan, however, the mandatory 20% funding cushion would absorb some, or possibly even all, of the asset losses that have occurred thus far due to the COVID-19 pandemic. In fact, the 20% funding cushion is designed for this exact purpose; to maintain benefit security during periods of severe economic turbulence.

While it is less likely that benefit reductions would need to occur in a composite plan than in a traditional pension plan, it could still happen. But a composite plan would have explained this possibility to participants from day one, and no promises would have been broken. In many ways, the funding crisis among traditional multiemployer pension plans did not occur because plans have insufficient assets to pay benefits. Rather, it occurred because nobody explained to participants that this could happen, and the plans do not have reasonable and timely mechanisms for adjusting benefits when necessary.

Case Study

Composite plans have two primary features that generate a high degree of long-term benefit security for participants and improved financial sustainability for employers.

- The first is that the trustees must set the benefit levels such that the plan will be projected to accumulate assets equal to 120% of the projected liabilities. The 20% funding cushion serves as a buffer against adverse experience.
- Second, when a severe downturn causes underfunding that the trustees are unable remedy with increased contributions, lower future benefit accruals, and cuts to ancillary benefits, the trustees have the authority to adopt reductions to accrued benefits. This tool is available only as a last resort, and is rooted in the belief that modest sacrifices adopted long before a plan is in danger of failure are preferable to the larger cuts that occur when a plan approaches the point of insolvency.

This case study considers how the experience of a traditional pension plan that currently faces severe funding distress would have been different if the stabilizing provisions of composite plans had been in place all along. Although the plan in this case study is a hypothetical plan and the figures in this analysis are deterministic projections based on the assumptions discussed below, the experience of this plan approximates that of an actual multiemployer plan that was certified to be in critical and declining status for the 2019 plan year.

Baseline Scenario – Traditional Pension Plan

This case study considers a traditional pension plan that was 75% funded immediately prior to the 2008 market crash. At that time, the plan was on pace to fully fund its liabilities, although not within the 15-year period that is generally prescribed by federal law. Determining the zone status requires a projection of the credit balance, which is beyond the scope of this analysis, but it is likely the plan would have been classified in endangered status for the 2008 plan year.

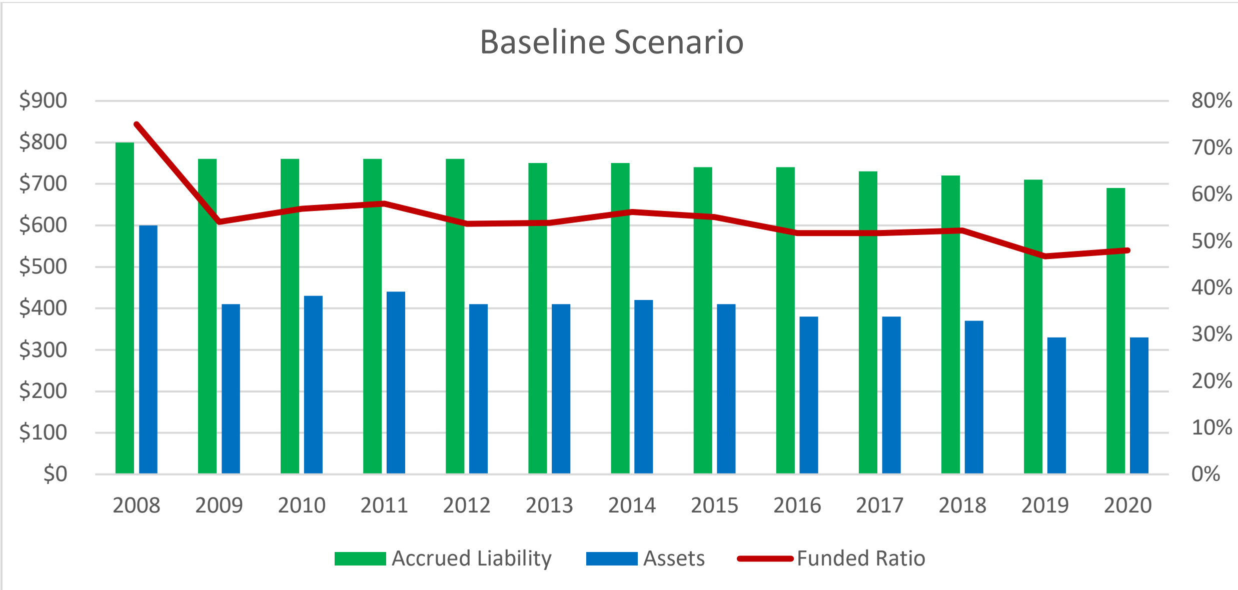
In the 2008 market crash, the plan assets are assumed to have declined by approximately 26%, and the plan also experienced an immediate 10% reduction in its level of covered work. After 2008 the active population continued to decline, with an annual rate of decline of 3% per year through 2014, and 1.5% per year after that. The funded ratio fell to 54% in 2009, and the plan was no longer projected to ever accumulate sufficient assets to cover all of the liabilities.

Following the 2008 downturn, the trustees of this hypothetical plan are assumed to have taken several actions to improve funding levels. The rate of benefit accrual earned by active participants was cut by 40%, and early retirement subsidies applicable to non-retired participants were scaled back, resulting in a 5% reduction in overall plan liabilities. Note that the benefit accrual cut represents a very large sacrifice on the part of active participants, while inactive participants are generally protected.

Additionally, a series of mandatory contribution rate increases were implemented that resulted in 4.5% annual increases in rates for 2009 through 2012, 3.5% annual increases for 2013 through 2016, and 2.5% annual increases thereafter. No benefit accrual was earned on these contribution increases. These increases will place stress on the market competitiveness of the contributing employers, and the trustees determined that any larger increases would drive employers either out of the plan or out of business.

Despite these measures, the funding level of the plan continued to trend downward, and even the generally favorable investment returns that occurred between 2009 and 2020, as shown in the chart below, were insufficient to stabilize the plan. The trustees concluded that they had exhausted all reasonable measures to improve funding levels, and the plan entered critical and declining status due to its projected insolvency.

The following chart summarizes the funding position of the plan from 2008 through 2020.[5]



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Accrued Liability	$800	$760	$760	$760	$760	$750	$750	$740	$740	$730	$720	$710	$690
Assets	$600	$410	$430	$440	$410	$410	$420	$410	$380	$380	$370	$330	$330
Funded Ratio	75%	54%	57%	58%	54%	54%	56%	55%	52%	52%	52%	47%	48%
Investment Return	-26%	15%	11%	1%	10%	14%	7%	3%	10%	11%	-1%	15%	

Impact of Composite Plan Benefit Security Features

Now consider how the situation would have been different had the plan historically been subject to the 20% funding cushion that applies to composite plans, and had trustees been empowered to reduce accrued benefits as a last resort when other measures are insufficient to adequately improve projected funding levels.

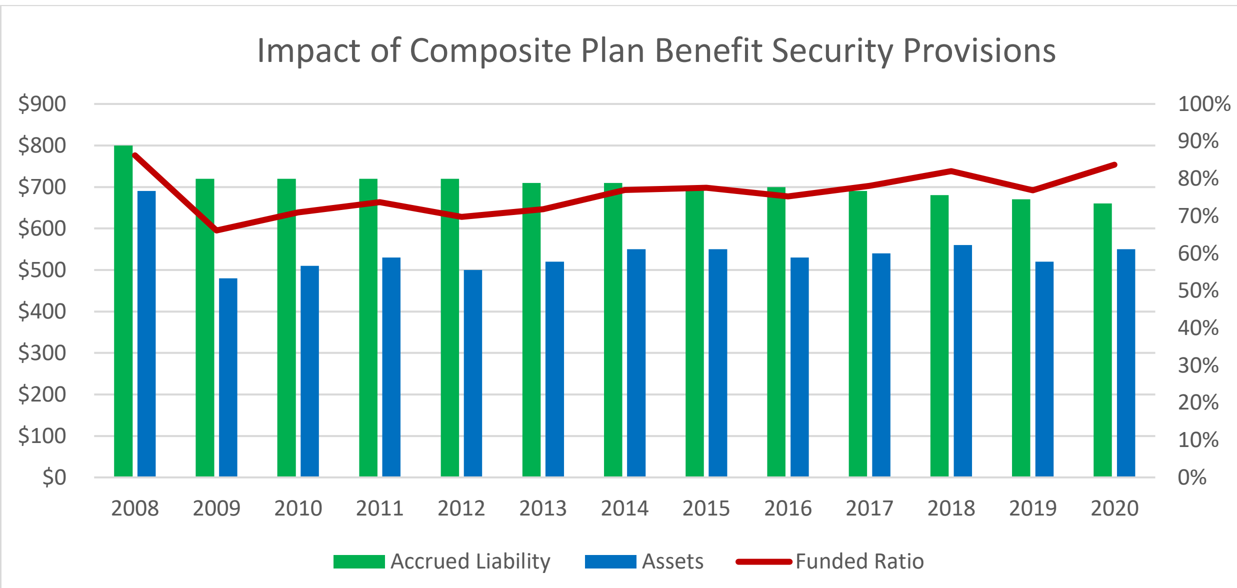
It is possible that the historical application of the 20% funding cushion would have meant that this plan would have held 20% more assets in 2008 than it did under the current pension rules. But is also possible that despite any legal obligation to do so, at some point in the past the trustees of the traditional defined benefit plan may have made decisions that would have caused the plan to be projected to be more than 100%

[5] In addition to the figures shown in the chart, the plan had an initial contribution level of $24 million, normal cost of $8 million, and benefit payments of $60 million.

funded. This case study assumes that if the plan had historically been required to target a projected funded ratio of 120%, at the beginning of 2008 its assets would have been 15% higher than they were under the current funding rules.

This case study also assumes that in 2009 the trustees would have taken the exact same corrective measures related to contribution rates, future benefit accruals, and adjustable benefits, as in the baseline scenario. However even with the additional 15% of assets held by the plan, these measures would have been insufficient to be projected to return the plan to financial health. The case study therefore further assumes that the trustees would have exercised their authority to reduce accrued benefits when necessary by implementing an across the board benefit reduction of 5%. The benefits affected by this reduction could later be restored if the plan recovers sufficiently.

The following chart summarizes the position of this plan from 2008 through 2020.



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Accrued Liability	$800	$720	$720	$720	$720	$720	$710	$710	$700	$690	$680	$670	$660
Assets	$690	$480	$510	$530	$500	$520	$550	$550	$530	$540	$560	$520	$550
Funded Ratio	86%	66%	71%	74%	70%	72%	77%	78%	75%	78%	82%	77%	84%
Investment Return	-26.0%	15.0%	11.0%	1.0%	10.0%	14.0%	7.0%	3.0%	10.0%	11.0%	-1.0%	15%	

The combination of the higher initial funding target and the ability of the trustees to immediately adopt a modest benefit cut has resulted in the following:

- The higher funding target and ability of the trustees to proactively reduce benefit levels when necessary to protect the solvency of the plan produced a 2020 funded ratio of 84%, as opposed to 48% in the baseline scenario.
- The baseline traditional pension plan was projected to fully exhaust its assets in less than 15 years following the 2020 plan year, while the composite plan benefit security provisions resulted in the plan being projected to be fully funded over a 10-year timeframe.
- The baseline traditional pension plan would have needed to impose a benefit cut of over 40% in 2020 in order to be in roughly the same funded position as was achieved with the composite plan benefit security provisions.
    - The traditional pension plan could have likely avoided projected insolvency with a benefit reduction below 40% in 2020, although such a lesser reduction would not have returned the plan to a healthy long-term funding outlook, and the plan would have remained highly vulnerable to adverse experience.

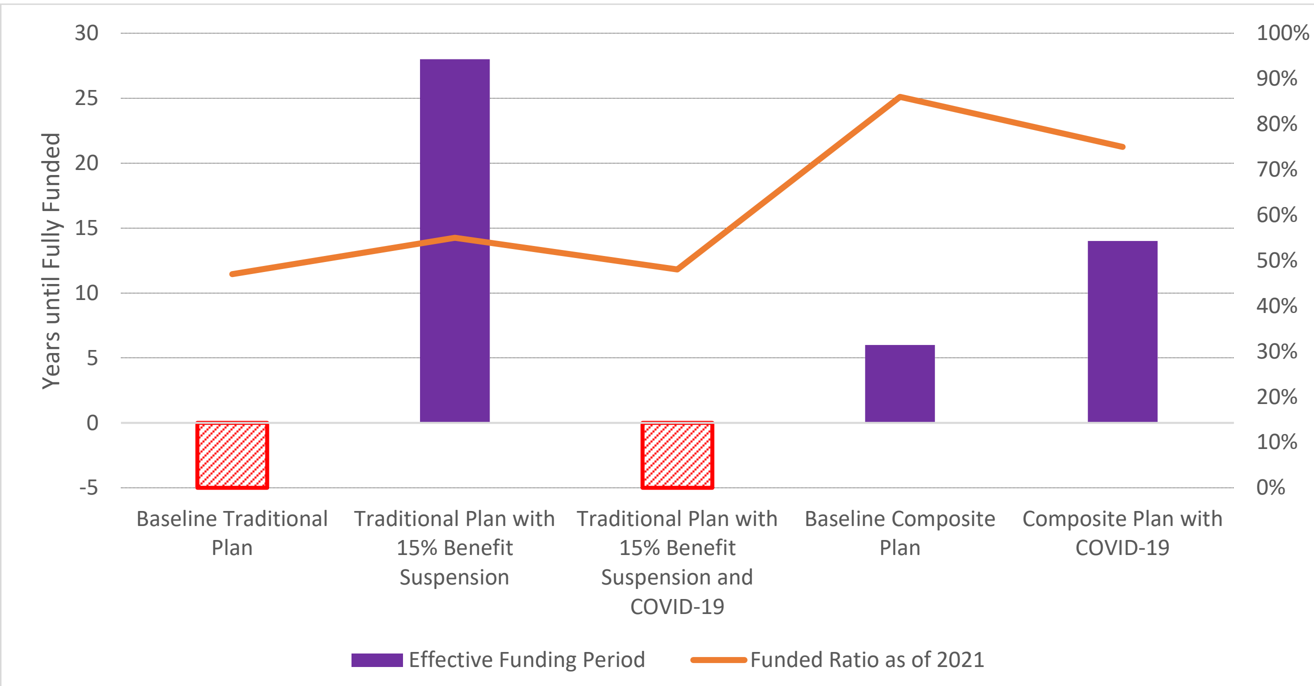
This scenario illustrates the powerful effect of the benefit security provisions of the composite plan model. No trustee would want to impose any benefit cuts on participants, and it is tempting to conclude that providing trustees with this authority would serve to impair benefit security. But as shown in this example, a small cut that is implemented immediately following a downturn can help prevent a much larger benefit reduction down the road, or worse the collapse of the plan entirely.

Impact of COVID-19 Crisis

With the COVID-19 pandemic triggering the closure of large segments of the economy and a sharp decline in the financial markets, the next economic downturn is upon us. As of the middle of May, the S&P 500 Index is down approximately 10%, and many multiemployer pension plans are reporting substantial declines in their levels of covered employment.

While the long-term economic effects of the pandemic are highly uncertain, as an illustrative example this case study assumes that plan assets will experience a 5% decline in 2020, and that a 15% drop in the active employee population will occur. This workforce decline is meant to provide a sense of scale as to the impact that the COVID-19 crisis could have on a pension plan, and is not intended to represent the expected experience of any particular plan or industry.

The chart below shows both the funded ratio and the effective funding period of the plan as of the 2021 plan year under several scenarios.[6] The lines show the 2021 funded ratio of the plan under each scenario. The bars indicate the period of time over which the 2021 contribution level is expected to fully fund the benefit liabilities (i.e., a shorter bar corresponds to a stronger funding outlook, while a larger bar means it will be longer before the plan is fully funded). A red bar with a negative value indicates that the current contribution level is never expected to fully fund the benefits.



<u>Baseline Traditional Plan</u> – This is the first scenario discussed in this case study, prior to the impact of the COVID-19 pandemic. The plan is slightly less than 50% funded, and is projected to be insolvent within 15 years.

<u>Traditional Plan with 15% Benefit Suspension</u> – This scenario assumes that the traditional pension plan adopted a 15% across the board benefit reduction in 2019 under Multiemployer Pension Reform Act of 2014. This benefit cut raised the funded percentage to roughly 55%, and was sufficient to eliminate the projected insolvency of

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[6] For this calculation, the effective funding period was determined by comparing the excess of the employer contributions over the value of participant benefit accruals for the year, and solving for the period over which this amount will amortize the unfunded liability.

the plan. Prior to the COVID-19 pandemic, the plan was on pace to fully fund its liabilities in just under 30 years.

Traditional Plan with 15% Benefit Suspension and COVID-19 – The 15% benefit suspension prevented the looming failure of the plan, but left it highly vulnerable to any subsequent adverse experience. As a result, the impact of the pandemic immediately returned the plan to a position of imminent failure.

Baseline Plan with Composite Benefit Security Features – This is the second scenario discussed in this case study, prior to the impact of the COVID-19 pandemic. The combination of the higher initial funding target and the 5% benefit reduction implemented immediately following the 2008 market crash resulted in the plan being approximately 85% funded in 2021 and on pace to be fully funded in roughly 5 years.

Composite Benefit Security Features with COVID-19 – The COVID-19 pandemic lowered the funded ratio to roughly 75% and extended the funding period from 5 years to almost 15 years. But significantly, the relatively strong position of the plan entering 2020 means that participant benefit security remains strong. The plan is not projected to be insolvent, and could likely weather the storm without taking any further remedial actions. This contrasts with the traditional pension model, where despite cutting all benefits by 15% in 2019, the plan was not expected to survive the COVID-19 crisis.

Key Takeaways

The composite plan model requires a more conservative funding approach than traditional plans, and empowers trustees to proactively adopt benefit reductions as soon as severe funding shortfalls develop. As illustrated in this case study, these provisions serve to greatly enhance long-term benefit security.

In the wake of the 2008 market crash, the traditional pension plan was unable to take sufficient action to return it to financial health. As a result, its only option for survival was to implement a 15% benefit cut under MPRA once it reached the point of imminent failure. This cut did not return the plan to long-term financial health, as it was the bare minimum needed to avoid projected insolvency. The occurrence of the COVID-19 pandemic following the 15% benefit cut returned the plan to a position of expected insolvency.

While the composite provisions allowed the trustees to impose a 5% benefit reduction immediately following the 2008 market crash, that action helped stabilize the plan and get it on a path back to financial health. This early action, in conjunction with the higher initial funding target, placed the plan in a much stronger long-term position than the traditional pension plan. Specifically, the traditional plan implemented a 15% cut and was still projected to be insolvent following the COVID-19 crisis, while the 5% cut applied early in the composite plan scenario was sufficient to both recover from the 2008 crash and get through the pandemic.

Conclusion

The multiemployer pension system has achieved great success and is also in the midst of a terrible failure. Many millions of blue collar workers have received vital retirement benefits from these plans and will continue to do so in the future, but more than a million participants will see their benefits vanish unless Congress steps in with a last minute rescue. Strengthening the system for the future requires both an appreciation of the successes and an honest assessment of the failures. It also requires a willingness to reconsider preconceived notions about how pension plans work.

The composite plan model derives benefit security from conservative funding principles and early corrective action in response to funding imbalances. By providing employers with the cost predictability they need to be successful in their businesses, composite plans will achieve greater long-term employer participation than traditional pension plans, further enhancing benefit security. The multiemployer pension system needs to be open to new ideas in order to evolve and meet the needs of future generations of workers and retirees. Composite plans are a voluntary approach that would give plan sponsors much needed flexibility as they look for ways to provide sustainable lifetime income to participants.

This White Paper is presented by the Associated General Contractors of America, FCA International, International Council of Employers of Bricklayers and Allied Craftworkers, Mechanical Contractors Association of America, National Electrical Contractors Association, Sheet Metal and Air Conditioning Contractors' National Association, Signatory Wall and Ceiling Contractors Alliance, and The Association of Union Constructors.

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The analysis in this white paper was prepared in accordance with generally accepted actuarial principles and practices. Josh Shapiro meets the applicable Qualification Standards of the American Academy of Actuaries. The results contained in this paper are based on the assumptions discussed herein, and different assumptions, or experience that deviates from these assumptions, would produce different results.

AGC THE CONSTRUCTION ASSOCIATION

FCA INTERNATIONAL

ICE INTERNATIONAL COUNCIL OF EMPLOYERS of Bricklayers and Allied Craftworkers

NECA NATIONAL ELECTRICAL CONTRACTORS ASSOCIATION

MCAA Mechanical Contractors Association of America

SMACNA

SWACCA

TAUC The Association of Union Constructors