Composite Plans:
A Better Approach to Variability

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Current Multiemployer Pension Benefits

- Plans typically provide fixed-dollar benefits
- Trustees set benefit levels
  - Increases may apply to both past benefits and future benefits
  - Decreases typically limited to future benefits
- Once earned, benefits not expected to change
  - ERISA rules generally prevent discretionary cuts
  - Limited exceptions for underfunded plans
- Dramatic cuts to all benefits when plan assets are exhausted

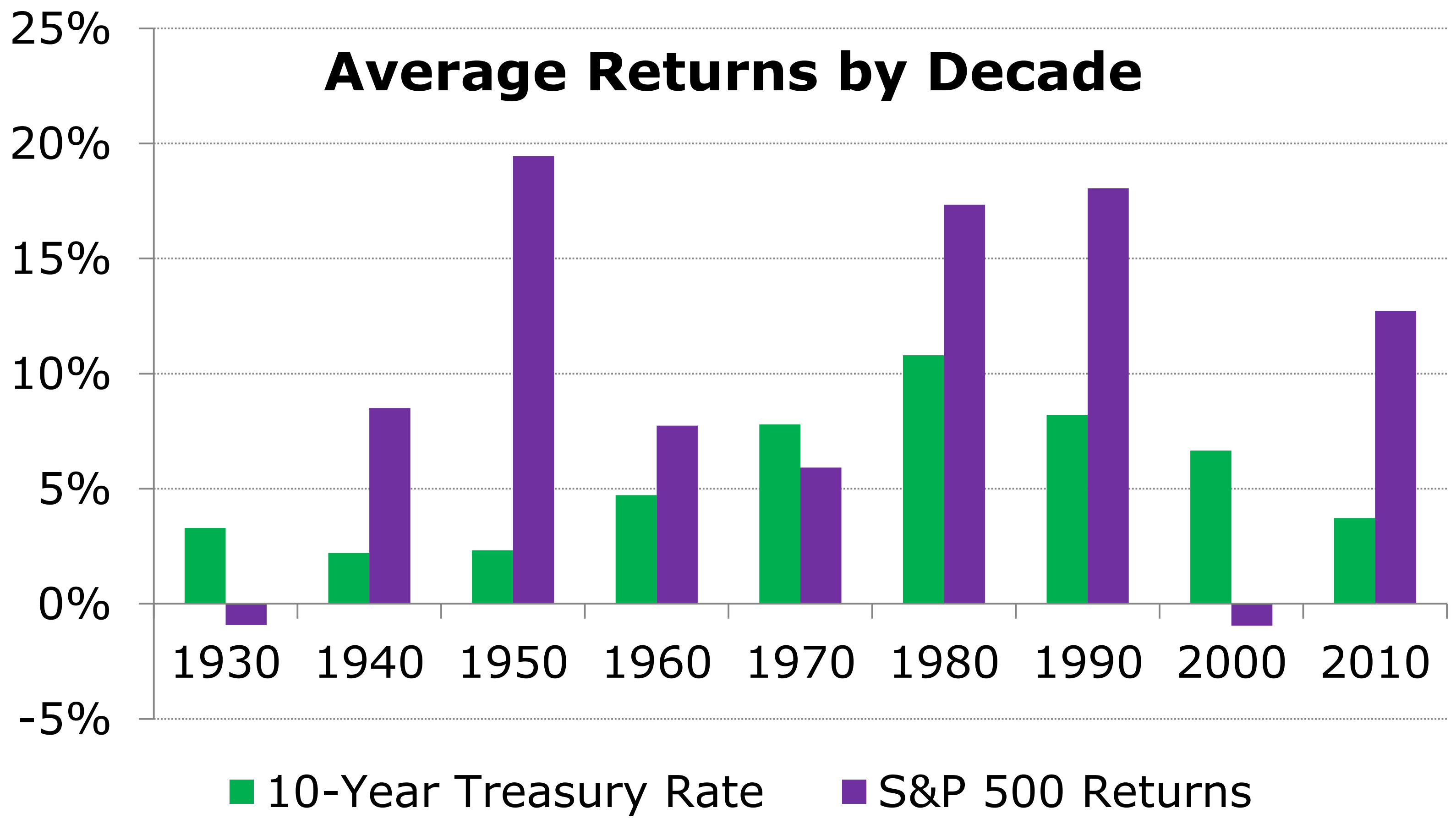
Contribution Levels

- Contribution amounts depend on:
  - Bargained contribution rates
  - Level of covered employment
- ERISA funding standards apply
  - Contributions expected to fund plan over 15 years
  - Limits to how high contribution rate can go
  - If experience is poor, it may be impractical for contributions to meet 15-year target
  - Trustees obligated to take reasonable measures to maximize contribution revenue

Plan Assets

- Assets invested in diversified portfolios
  - Generally consist of various asset classes
  - Stable investments tend to produce lower returns than more volatile investments
  - Higher returning classes are less predictable
- Asset returns are uncertain
  - Long-term returns have been very strong
  - Substantial losses may occur over shorter timeframes

Returns on Risky Versus Safe Investments



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Withdrawal Liability

- Plans cannot prevent employer withdrawals
- Withdrawal liability assessments
  - Required by ERISA
  - Proportionate share of underfunding
- Withdrawal liability limitations
  - Collection experience often poor
  - Employers may pay assessment in quarterly installments over many years
  - 20-year cap on payment schedule

Benefit Security

- What is a guarantee?
  - Something that is said?
  - A promise to do something?
  - An observation about the likelihood of something happening?
- Does guarantee mean 100% certainty?
  - Almost nothing is completely certain
  - Guarantee implies very close to 100% certainty

Benefit Security

- Multiemployer pension benefits are not guaranteed
  - Asset portfolios can produce significant losses
  - All industries can decline
  - Companies can become distressed
  - Withdrawal liability is limited
- Possible that benefits will not be paid in full
  - Likelihood may be very small, but it’s not trivial
  - A secure benefit is not the same as a guaranteed benefit

Paths Forward

- Current defined benefit system
  - Stakeholders need to better understand risks
  - Mechanisms for dealing with risks may not be adequate
- Possible to adopt a very low risk funding approach
  - Invest plans assets in highly secure bonds
  - Pension benefits would become guaranteed
  - Dramatic increase in costs or decline in benefits
  - Guarantees are expensive

Composite Plans

- Composite plans operates very similar to current defined benefits plans
  - Negotiated contribution rates
  - Board of trustees sets benefit levels
  - Trustees held to fiduciary standard of care
  - All benefits paid as annuities
  - Investment, mortality and other experience shared across plan population

Composite Plans

- Composite plan benefits are secure, but not guaranteed
- When significant underfunding occurs, trustees must take immediate action
- Legislation prescribes a series of steps
- Initial steps do not cut any accrued normal retirement benefits
  - Opportunity for increased contributions
  - Reduce future benefit accruals
  - Scale back ancillary plan features

Composite Plans

- Only in extraordinary situations will initial steps be insufficient
  - Historical experience
  - Actuarial modeling
- If necessary, active accrued benefits may be reduced
- Only as a last resort, core retiree benefits may be reduced

Composite Plans

- Benefit reductions
  - Can occur in both DB and composite plans
  - Possible in any plan not using risk-free funding
- Timing of reductions
  - Occur much earlier in composite plans
  - Early intervention has enormous impact on magnitude of reductions
  - Composite plans likely to have more frequent reductions that are small
  - DB plan reductions rare, but can be catastrophic

Composite Plans

- Composite plan benefits may be more secure than DB benefits
  - Mandatory 20% funding cushion
  - Immediate action necessary when shortfall develops
  - Far easier to attract and retain employers
  - Virtually impossible for plans to become insolvent

Questions?

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