The Impact of Alternative Discount Rates on Multiemployer Pension Plan Funding - Highlights

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Genesis

- **Joint Select Committee on Solvency of Multiemployer Pension Plans**
  - Established on February 9, 2018 as part of the Bipartisan Budget Act of 2018
  - Bipartisan 16 member committee
  - Tasked with developing a report and proposed legislation by November 30, 2018
- **Goals**
  - Improve solvency of multiemployer pension plans
  - Improve solvency of PBGC
- **Consideration of measures that would affect <u>all plans</u>**
  - PBGC premium increases
  - Mandated discount rates
  - Other changes to funding rules?
- **Horizon worked with NCCMP to educate lawmakers on why mandating discount rates would be a bad idea for multiemployer pension plans**

Highlights

- **Based on Form 5500 data**
  - 1,253 plans covering about 10.4 million participants were analyzed
  - In general, data covers plan years beginning from September 1, 2015 through August 1, 2016
- **Using corporate bond rates**
  - The percentage of green zone plans would fall from over 60% to just 7%
  - The majority of plans would see contribution requirements ranging from 1.7 to 2.4 times current levels
- **Using 30-year US Treasury rates**
  - The percentage of green zone plans would fall from over 60% to a mere 2%
  - The majority of plans would see contribution requirements ranging from 2.0 to 3.0 times current levels
- **Bottom line: Using alternative discount rates is not appropriate for multiemployer pension plans**
- **Doing so would hasten the demise of the system rather than fortify it**

Unfunded Liability

Unfunded liability by zone status when moving from current rates to corporate bond rates

Zone Status	Current Rates	Corporate Bond Rates	Increase vs. Current Rates
Critical & Declining	$ 49.9	$ 81.6	63%
Critical	35.5	79.5	124%
Seriously Endangered	0.9	1.9	120%
Endangered	30.5	74.9	146%
Green Zone	53.3	222.6	317%
Total	**$ 170.2**	**$ 460.5**	**171%**

$ billions

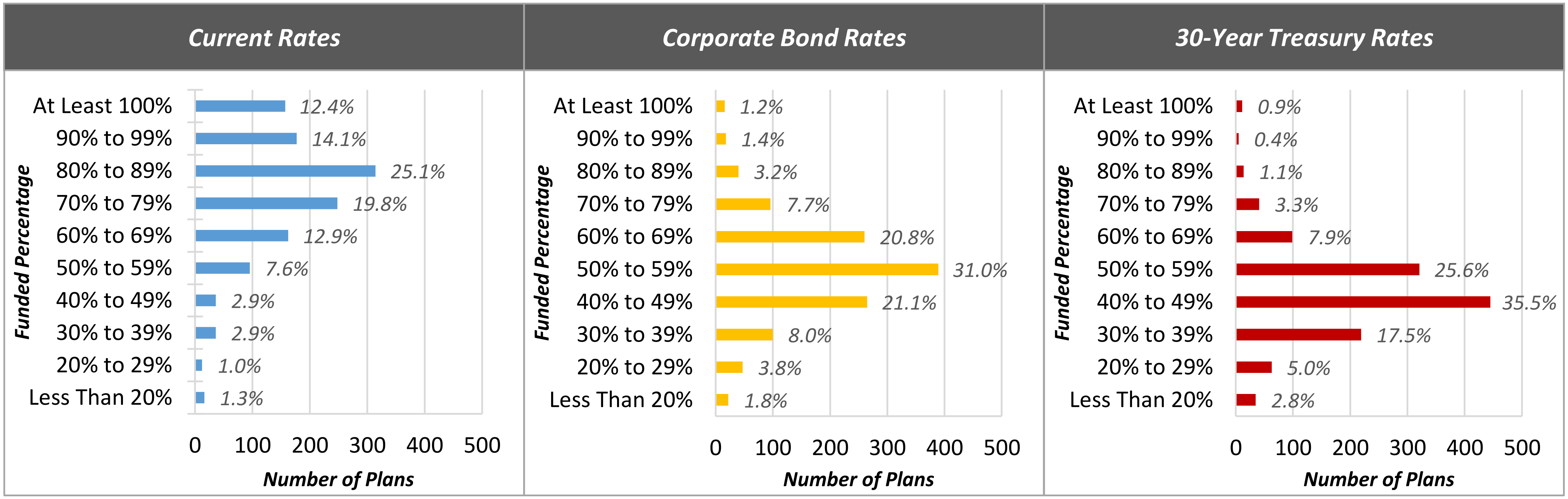
Unfunded liability by zone status when moving from current rates to 30-Year Treasury rates

Zone Status	Current Rates	30-Year Treasury Rates	Increase vs. Current Rates
Critical & Declining	$ 49.9	$ 98.6	97%
Critical	35.5	101.4	185%
Seriously Endangered	0.9	2.4	182%
Endangered	30.5	95.2	212%
Green Zone	53.3	311.6	484%
Total	**$ 170.2**	**$ 609.3**	**258%**

$ billions

Funded Percentage

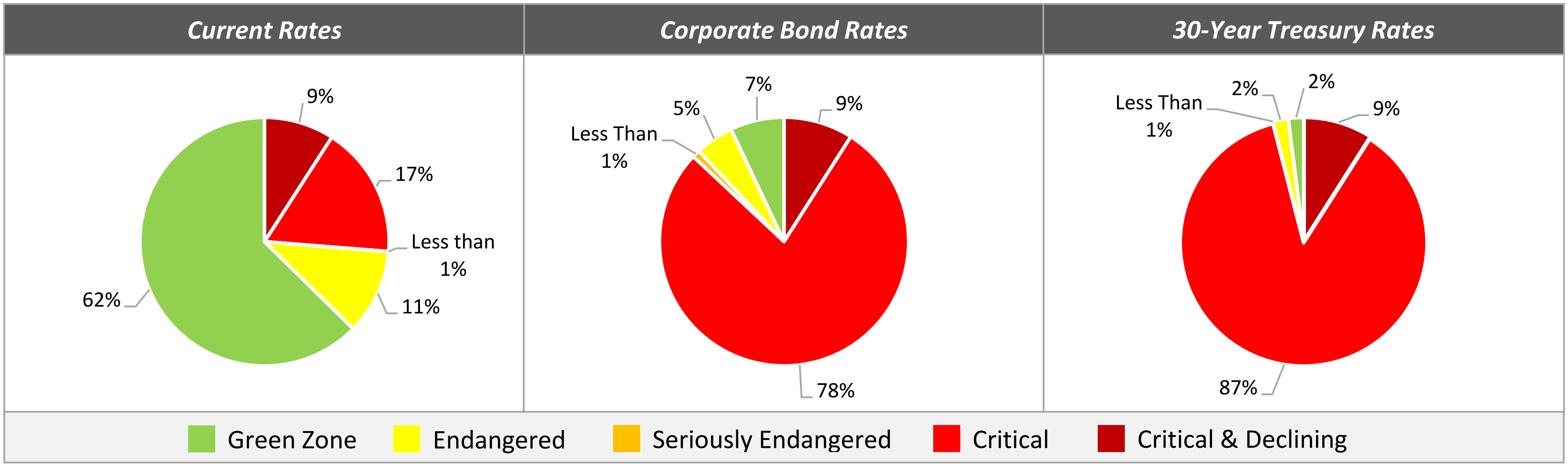
Distribution of multiemployer plans by funded percentage at various discount rates using the market value of assets



- Over half of plans are more that 80% funded using current rates
- Only 6% of plans are more than 80% funded using corporate bond rates
- Only 2% of plans are more than 80% funded using 30-Year Treasury rates

Zone Status

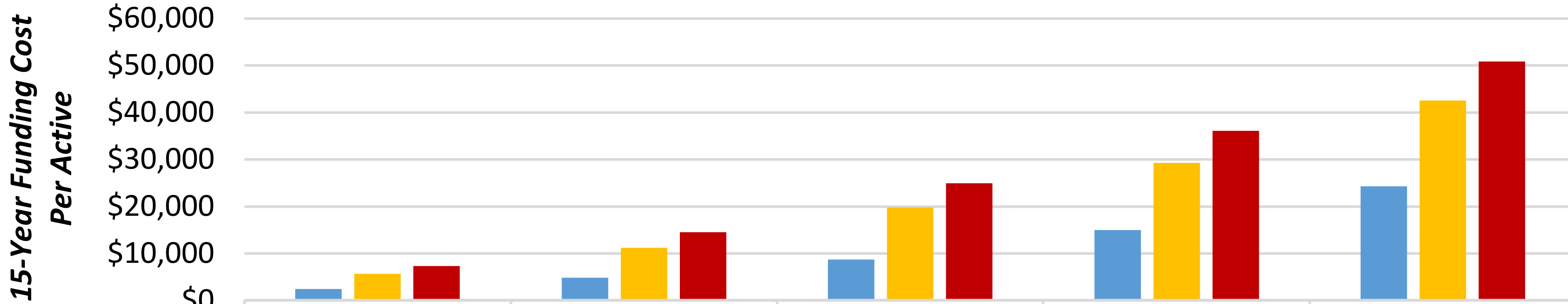
Distribution of multiemployer plans by PPA zone status based on various discount rate assumptions



- Over 60% of plans are in the “Green Zone” using current rates
- Only 7% of plans would be in the “Green Zone” using corporate bond rates
- Only 2% of plans would be in the “Green Zone” using 30-Year Treasury rates

Contribution Requirements

Distribution of 15-year funding cost determined at various discount rates per active participant



	10th Percentile	25th Percentile	50th Percentile (Median)	75th Percentile	90th Percentile
Current Rates	$2,400	$4,800	$8,700	$15,000	$24,300
Corporate Bond Rates	$5,700	$11,200	$19,800	$29,300	$42,500
30-Year Treasury Rates	$7,300	$14,500	$24,900	$36,100	$50,800

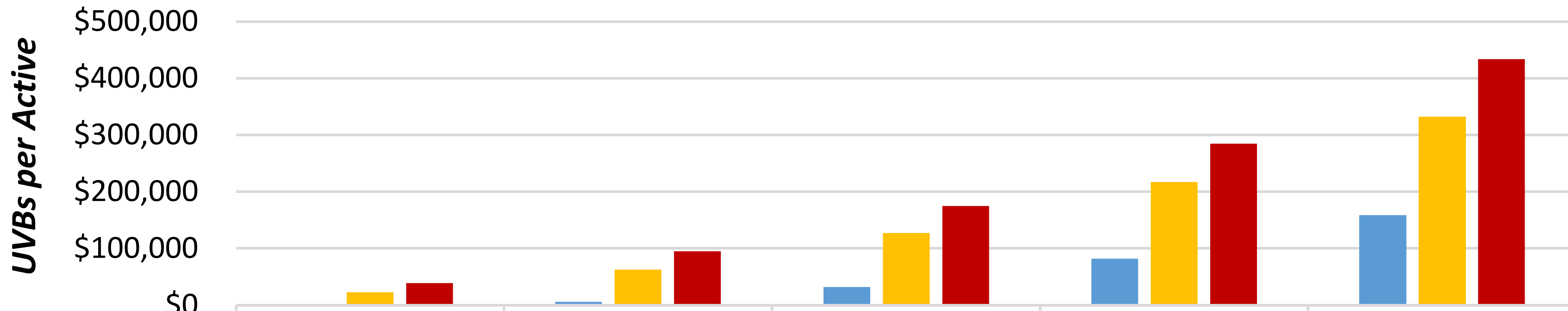
- The majority of plans would see contribution requirements ranging from 1.7 to 2.4 times current contribution requirements when moving to corporate bond discount rates
- The increases would be even greater at 2.0 to 3.0 times current contribution requirements when moving to 30-year Treasury discount rates

Contribution Volatility

- On top of increasing costs, the use of alternative discount rates would introduce <u>additional contribution volatility</u> for most plans
- Contribution requirements could change considerably from year-to-year solely due to fluctuations in the level of discount rates
- This added volatility would be especially burdensome for multiemployer pension plans, since contribution rates are generally fixed for three or more years through the collective bargaining process
- Having a stable funding target is important for any organization, and increasing contribution volatility is likely to exacerbate the concerns of the employers participating in these plans

Withdrawal Liability

Distribution of unfunded vested benefits determined at various discount rates per active participant



	10th Percentile	25th Percentile	50th Percentile (Median)	75th Percentile	90th Percentile
Current Rates	$0	$6,000	$32,000	$82,000	$159,000
Corporate Bond Rates	$23,000	$63,000	$127,000	$217,000	$332,000
30-Year Treasury Rates	$39,000	$95,000	$175,000	$285,000	$434,000

- Consider the 50th percentile (median) per-active UVBs between in the exhibit above
- Plans near the median would see an increase in per-active UVBs of 4.0 times current levels when moving to corporate bond rates
- The increase is 5.5 times current levels when moving to 30-year Treasury rates

Impact on a Representative Plan

Consider the impact on a representative multiemployer plan

- The plan has an average monthly benefit accrual of $78
- Benefit formula results in an average annual pension benefit of $28,080 for a 30-year career employee
- The average contribution rate is $8.00 per hour

	Current Rates	Corporate Bond Rates	30-Year Treasury Rates
Actuarial Accrued Liability	$ 127	$ 182	$ 213
Market Value of Assets	102	102	102
Unfunded Liability	$ 25	$ 80	$ 111
Funded Percentage	80%	56%	47%
PPA Zone Status	Green Zone	Critical	Critical

Impact on a Representative Plan

The vast majority of contributions would be used to pay down unfunded liabilities for benefits already earned

(This Plan's Average Contribution Rate is $8.00)

	Plan Cost ($ per Hour)		
	Current Rates	Corporate Bond Rates	30-Year Treasury Rates
Unfunded Liability	$ 3.64	$ 9.36	$ 12.27
Normal Cost	3.37	5.91	7.57
Operating Expenses	0.68	0.68	0.68
Total Plan Cost	**$ 7.69**	**$ 15.95**	**$ 20.52**

The percentage of payroll required to fund the pension plan would more than double using corporate bonds and would almost triple using 30-year Treasury rates

	Plan Cost as a % of Wages ($35 per Hour)		
	Current Rates	Corporate Bond Rates	30-Year Treasury Rates
Unfunded Liability	10%	27%	35%
Normal Cost	10%	17%	22%
Operating Expenses	2%	2%	2%
Total Plan Cost	**22%**	**46%**	**59%**

Consequences for Participants

- **Benefit reductions**
  - Overstating the benefit obligation would cause plans to adopt unnecessary measures to reduce benefits
- **Wage reductions**
  - Increased contributions are as likely to come from existing wage packages as they are from negotiated employer contribution increases
  - Unnecessary increases in required contributions would likely cause reductions in take-home pay for many plan participants
- **Reduced standard of living**
  - Even if plans were able to survive these unnecessary changes, the benefit and wage reductions described above would have a devastating impact on participants and their families both today and in retirement
- **Reduced benefit security**
  - The unraveling of the multiemployer pension system described on the prior page would ultimately jeopardize the retirement security of the 10 million participants in these plans

Consequences for Employers

- **Overstatement of contribution needs**
  - Multiemployer plans invest in fully diversified, professionally managed portfolios
  - Over time, these portfolios are expected to produce – and historically have produced – earnings well in excess of corporate bond or US Treasury yields
  - Using discount rates based on these lower yields would significantly overstate the contributions required to fund future benefits
  - On top of overstating contribution needs, the use of alternative discount rates would introduce unnecessary contribution volatility for most plans
- **Competitive pressures**
  - These contribution increases would make it harder for participating employers to compete, making it less likely for employers to remain in multiemployer plans
- **Increased risk of bankruptcy**
  - Increased contribution requirements along with increased withdrawal liability would lead to a significantly increased risk of bankruptcy
  - The many small and medium sized employers that participate in these plans would likely face the largest risk

Overall Impact

- **Required adoption of unnecessary measures**
  - Most plans would be forced to decrease benefits to levels that would not be appreciated by participants
  - Most plans would also be forced to increase contributions to levels that would be unsustainable for employers
- **Unraveling of the multiemployer pension system**
  - Benefit decreases and contribution increases would lead to decreased employee and employer participation
  - It would also lead to increased employer bankruptcies
  - Ultimately, the use of alternative discount rates would significantly decrease the benefit security of millions of hardworking men and women
- **Using discount rates based on risk-free assets is not appropriate for plans invested in a well-diversified portfolio of assets**

Naughton Rebuttal

Selected quote from the July 25, 2018 testimony of James P. Naughton and our response

"…multiemployer plans generally choose to invest in risky equity investments and to collect contributions that are inadequate relative to the promised benefits."

- **The investment risks that multiemployer plan trustees take are reasonable and prudent, given the long-term nature of the pension benefit promise**
  - Were these plans to invest in low risk bonds or annuity contracts, the risk would shift from funding and investment volatility to a risk of inadequate benefits
  - This would turn a limited crisis into a far more severe crisis, as older workers would be unable to retire, affecting workforce patterns with fewer opportunities for young workers to enter the workforce
  - In effect, this would turn a manageable and appropriate long-term investment risk into a greater societal and economic risk, exacerbating an ever growing retirement income crisis in the United States (where roughly half of the private sector workforce has <u>no</u> workplace retirement benefit)

Naughton Rebuttal

Selected quote from the July 25, 2018 testimony of James P. Naughton and our response

> *"If plans were required to collect actuarially sound contributions and purchase annuity contracts, there would be no crisis."*

- **Plans are required to – and actually do – collect "actuarially sound" contributions**
- **Were these plans to purchase annuity contracts to fund benefits, benefits would be drastically lower than current levels**
  - Multiemployer pension plans have for decades been a tax effective and economically efficient way for industry employers and workers to come together to provide retirement income to alleviate the risk of poverty in old age
  - While Mr. Naughton and Mr. Rauh are confident of the soundness of their positions, there is no contemplation of the unintended negative consequences of adopting this view of how multiemployer pension plan funding should work

Naughton Rebuttal

Selected quote from the July 25, 2018 testimony of James P. Naughton and our response

> *"In general, the assumption of risk is an appropriate course of action to the extent that one can respond to the inevitable volatility. Unfortunately, this is not the case with the multiemployer system, where there is a structural inability to respond to poor experience."*

- **The current multiemployer funding rules provide unlimited opportunities to both anticipate and respond to poor experience**
- **Many of our multiemployer plan clients weathered the 2008 economic storm without needing to increase contributions or reduce benefits**
  - They did this with the help of funding policies that provided funding "cushions" for adverse experience
  - These funding policies are typically developed through "stress testing" – evaluating what happens to plan funding under adverse experience
  - Stress testing is now required under the newly developed Actuarial Standard of Practice No. 51

Rauh Rebuttal

Selected quote from the July 25, 2018 testimony of Joshua D. Rauh and our response

> *"Giving the plan actuary or trustee discretion over the selection of the return they believe the portfolio will earn opens up the possibility of arbitrary selection of discount rates."*

- **The trustees <u>do not</u> have discretion over the selection of the assumed discount rate for multiemployer plans**
  - This is the responsibility of the plan's Enrolled Actuary
- **Actuaries must comply with strict Actuarial Standards of Practice in the selection of <u>all</u> assumptions**
  - Under these Standards, considerable analysis goes into the selection of these assumptions
  - One such example is our annual Survey of Capital Market Assumptions
  - Actuaries who exercise the "arbitrary selection" of discount rates face a serious risk of being disenrolled under ERISA or disciplined by the actuaries' professional body

Naughton Rebuttal

Selected quote from the July 25, 2018 testimony of James P. Naughton and our response

> *"First and foremost, multiemployer plans need to have accurate measurement of liabilities and strong funding rules so that they can provide promised benefits."*

- **These plans are in fact measuring liabilities accurately and reasonably, given the long-term nature of the obligation and the appropriate investment policies used by multiemployer plans**
- **The current funding rules work well for the vast majority of plans that fund well above minimum required levels**
- **Plans would do well to adopt or strengthen funding policies to avoid future funding problems**
- **There may be opportunities to adjust the current funding rules**
  - However, any such adjustment must be done carefully so as to help, not hurt, the ability of these plans to deliver the promised benefits

Contact Us

- For additional information, please download the full report:
  - www.horizonactuarial.com or www.nccmp.org

- If you have questions, please contact one of the authors of the report:

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