COMPOSITE PLANS: A NEW APPROACH TO MODERNIZING MULTIEMPLOYER RETIREMENT BENEFITS

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Executive Summary

In 2011 the Retirement Security Review Commission, consisting of stakeholders from both labor and management, met to discuss the future of the multiemployer retirement system. After a long period of discussion and deliberation, the group concluded that revitalizing the multiemployer system requires creating a new type of retirement plan. These plans are known as 'composite plans', and their objectives are:

- Provide adequate and reliable income in retirement to employees
- Ensure that sponsoring employers are not exposed to financial risks that jeopardize the viability of their businesses

Federal law currently limits plan sponsors to offering either traditional defined benefit pension plans or 401(k)-style defined contribution plans. Each of these options has certain weaknesses, with defined contribution plans struggling to successfully provide adequate and secure income to retired workers, and defined benefit plans placing financial risks on employers that are driving them out of the system.

Composite plans provide a voluntary way to bridge the gap between these two options, combining the lifetime income payments of defined benefit plans with the predictable cost structure of defined contribution plans. Since composite plans are neither defined benefit nor defined contribution plans, Congress will need to authorize their use before companies can begin to offer them to their employees.

The following key features of composite plans will ensure that they provide employees with reliable and cost-effective retirement benefits:

- No individual accounts - all assets invested in a single diversified portfolio with professional asset management, and all benefits paid as lifetime annuities calculated under a formula established by the plan trustees
- Funding policy that is required to target 120% of the actuarially calculated costs, which serves as a buffer against market volatility

Composite plans will also provide the cost predictability that is necessary to protect the financial viability of the contributing employers.

- Contribution obligation limited to the bargained contribution rate, which can only be increased by agreement between labor and management
- Absence of any withdrawal liability assessments or other fees payable when an employer exits the plan

Composite plans work by employing a flexible benefit structure that adapts to changing economic conditions. The plan trustees may increase benefit levels when significant gains occur, and subject to a variety of safeguards, they may reduce benefit levels if this action is necessary to maintain a strong long-term funding outlook.

When a group adopts the composite plan model, it will apply only to benefits earned in the future, while the current multiemployer pension rules continue to apply to benefits earned before the composite plan is adopted. The liabilities in the legacy pension plan will cease to grow, and over time they will diminish as benefits are paid out and participants earn accruals in the composite plan.

We know from experience that early corrective action is a key source of benefit security. When the actuarial projections show a funding imbalance, composite plans require early proactive measures to improve funding levels. These measures may include:

- Negotiating additional contributions
- Reducing the rate of future benefit accrual
- Scaling back non-core benefits, such as early retirement, spousal subsidies, and disability benefits.

Only after these options have been exhausted can the trustees consider adopting reductions to the core retirement benefits. Just as with current multiemployer plans, all boards of trustees will consist of an equal number of employer and employee representatives, which will further ensure retirement benefits are protected.

Extensive stress testing confirms that the composite plan model will work as intended. The positive experience of the Canadian multiemployer system, which closely resembles composite plans, is further proof of the viability of this approach.

The companies that currently participate in the multiemployer system take pride in the fact that they provide high-quality retirement benefits to their employees. The structure and safeguards of composite plans represent a responsible way for them to continue to do this, without taking on financial risks that threaten the survival of their businesses.

Introduction

Several years ago, representatives from both labor and management formed the Retirement Security Review Commission in order to discuss ideas on how to revitalize the multiemployer pension system. After many months of discussion, analysis, and debate, the result of this process was a proposal for a new type of retirement plan called a 'composite plan'.

Composite plans are a new and innovative approach to providing retirement benefits to multiemployer plan participants. In a time when more and more workers are financially unprepared for retirement, composite plans represent a modernized approach that is viable for the future. These plans have two primary objectives:

- Provide adequate and reliable income in retirement to employees
- Ensure that sponsoring employers are not exposed to financial risks that jeopardize the viability of their businesses

In order to accomplish these objectives, the composite plan structure has the flexibility to adapt to both strong and weak economic conditions, which creates benefit security for participants and cost stability for plan sponsors. This is especially important during difficult economic times when plans become underfunded, as the composite plan rules require swift action to improve funding levels, while giving labor and management the flexibility to develop solutions that meet their specific needs.

As with current multiemployer retirement plans, composite plans would be products of the collective bargaining process between labor and management. Current pension law limits employers to offering either defined contribution plans such as 401(k) plans, or traditional defined benefit pension plans. As composite plans are neither, in order for companies to begin offering them to their employees, Congress will need to enact legislation authorizing their use.

Why are Composite Plans Needed?

Effectively, companies have been forced to choose between protecting their businesses and protecting their employees. Composite plans provide a way for employers to do both. **Composite plans take the best features of the options that are available under current law by combining the predictable costs of 401(k) style defined contribution plans with the lifetime income features of traditional defined benefit plans.**

Composite plans are a voluntary 'best of both worlds' approach that will help reverse the recent trend away from pension plan sponsorship by providing an option that truly meets the needs of both the employees and the employers. They will also help to reduce multiemployer plans' reliance on the insurance provided by the Pension Benefit Guaranty Corporation, as the high degree of adaptability of composite plans makes this insurance unnecessary.

Under current law, the companies that want to provide retirement benefits to their employees face a difficult choice:

- They can offer a traditional defined benefit pension plan, with the knowledge that when economic conditions cause pension costs to increase, they will bear the burden of these increased costs while many of their competitors will not.
- Alternatively they can offer a 401(k) style defined contribution plan, knowing that these plans place risks and burdens on employees who may lack the proficiency to manage them.

The vast majority of companies that sponsor multiemployer pension plans are small businesses, which in many cases have been handed down through several generations of family members. These employers understand the importance of retirement income security to employees, and they take pride in the fact that their employees are able to maintain a decent standard of living in retirement following a lifetime of work. Composite plans represent an opportunity for these companies to

"Composite plans will provide another voluntary option to provide workers with the financial security that they need in retirement, and have the flexibility to remain sustainable in today's rapidly changing economy."

— Sean McGarvey, President of the North America's Building Trades Unions, Washington D.C.

"As an owner, I'm proud to provide my employees with quality benefits. Composite plans will allow me to continue to do this without risking my company's survival."

— Carol Duncan, Owner and CEO of General Sheet Metal (GSM), Clackamas, Oregon

continue to provide high-quality retirement benefits to their employees, without taking on financial risks that could ultimately cause the demise of their businesses.

Advantages of Composite Plans

Employee Perspective – *The Advantages of Composite Plans over Defined Contribution Plans*

Professional Asset Management: Composite plans provide for professional asset management and the sharing of risks, both of which enable these plans to provide retirement security to participants far more efficiently than is currently possible in defined contribution plans such as 401(k) plans. Today many defined contribution plan participants struggle with how to manage their investments while they are working, and how to convert those investments into retirement income once they retire. Composite plans possess design features that address both of these issues, ensuring that they maximize the amount of retirement income they provide while minimizing both cost and risk.

Benefit Security: All composite plan assets are invested in a single diversified portfolio that allows the trustees to negotiate the lowest possible fee arrangements with managers and advisors while maintaining a long-term investment strategy. **Composite plans also have several design features that provide benefit security during periods of economic weakness.** These features include:

- A funding structure that mandates that projected plan assets exceed the expected benefit obligations by 20%
- The ability for the bargaining parties to negotiate higher contribution levels in order to improve funding without reducing any benefits
- A requirement that plans protect benefits that participants have already earned by reducing the rate of future benefit accrual as an initial response to funding challenges

In a 401(k) plan, the employer deposits contributions into employees' individual accounts during their working years, and each individual employee is responsible for deciding how to allocate the contributions among numerous investment options. When investment losses occur, there are no provisions in these plans that provide any protection to participants. A typical multiemployer plan participant is a middle-class worker, who in most cases does not have the time, expertise, or resources that are necessary to develop an investment strategy that effectively balances long-term returns with downside risk management.

Lifetime Annuity: Composite plans pay all benefits as lifetime annuities, which means that it is impossible for retirees to outlive their savings. This feature represents an enormous advantage over 401(k) plans, as it is exceptionally difficult for an individual participant to develop an efficient strategy for drawing down an individual retirement account. Imagine a 60-year old worker who has never had more than a few thousand dollars in the bank suddenly receiving a check for half a million dollars. This money needs to provide income over a retirement that could last anywhere from several months to several decades. How do you prudently spend this money in a way that balances the desire to enjoy the rewards of a lifetime of hard work with concerns about being impoverished at age 85? By paying all benefits as lifetime annuities, composite plans provide longevity protection that will prevent elderly participants from needing public assistance in the final years of their lives.

Employer Perspective – *The Advantages of Composite Plans over Defined Benefit Plans*

Ability to Provide Secure Benefit for Employees at Predictable Costs: From the perspective of the employers, composite plans have the advantage of predictable costs. In a composite plan, the employers are only obligated to contribute the amounts that are negotiated in collective bargaining agreements, and they do not take on any liabilities outside of these amounts. As such, the primary factors that have made companies reluctant to sponsor multiemployer defined benefit plans are entirely absent from composite plans.

In traditional defined benefit plans, the

employers bear the risk of plan asset losses. When the plan assets decline, the employer costs and liabilities rise in response to those losses. The result is that the companies that choose to provide these plans to their employees have unpredictable cost structures, while the companies that choose not to provide their employees with quality retirement benefits have much greater cost stability. The inevitable consequence is that despite their value to employees, employers have been forced to move away from traditional defined benefit plans in order to remain competitive and financially viable. Today very few companies are willing to enter the multiemployer defined benefit system, and many of those that currently participate are looking for opportunities to exit. Composite plans address this issue by strictly limiting the employers' obligations to the amounts negotiated in collective bargaining agreements.

Stable Transition from Traditional DB Plan: In addition, for companies that currently sponsor traditional defined benefit pension plans that are underfunded, a transition to the composite model would allow them to more efficiently address those unfunded liabilities by ensuring that employees' future years of service do not cause the liabilities to grow.

How Composite Plans Work

Composite plans will pay benefits in the same manner as current defined benefit plans. There will be a benefit formula that determines the amount of retirement income each participant receives. Plans may include early retirement provisions, disability benefits, spousal benefits, and other optional features. Like all multiemployer plans, a board of trustees consisting of an equal number of employee and employer representatives will be responsible for setting the provisions of the plan.

A composite plan will determine its funded position by first measuring the assets and liabilities of the plan, and then projecting these values 15 years into the future based on expected contributions, benefit accruals, benefit payments, and asset returns. If the ratio of the projected assets to the projected liabilities equals or exceeds 120%, the plan will be considered to be in good shape and can continue to operate as is. If this ratio is below 120%, the plan will be required to take prompt action to improve its projected funding level.

As with traditional defined benefit plans, the measures used to improve funding levels in a composite plan may take many forms.

- When faced with a funding shortfall, trustees' initial reaction will often be to provide the bargaining parties with an opportunity to negotiate a higher contribution rate that will pay off the shortfall.
- If necessary, the trustees will also respond by reducing the rate of future benefit accrual.
- In the rare cases when these tools are insufficient, plans can also respond by scaling back ancillary benefits such as early retirement subsidies and disability benefits as a way to improve the long-term funding outlook.

Historically, in all but the worst of economic conditions, multiemployer defined benefit plans have been able to correct funding imbalances using only the tools described above, and the same will be true for composite plans. During the most severe of economic catastrophes, such as the 2008 financial market collapse, these tools may not be enough for some plans. In the event that the projected funded ratio of a composite plan remains below the required level after the application of all of the measures outlined above, the trustees of composite plans will have the flexibility to adjust benefits that participants have already earned in order to raise the projected funded ratio. Since both labor and management have equal voices on the board of trustees, this decision will require agreement from both sides.

The ability of a composite plan to adjust benefits that participants have already earned will only be available after the plan has exhausted all other measures to improve its funding level, and can only be utilized with the approval of the employee representatives who make up half of the board of trustees. In the event that extraordinary economic difficulties force a plan into a position where it needs to take this step in order to return to financial health, prompt action is vital to preserving

"The experience in Canada has been that multiemployer plans provide secure retirement benefits while maintaining strong support from both the labor and employer communities."

— Mike Mazzuca, Director of the Multi-Employer Benefit Plan Council of Canada and partner at the law firm Koskie Minsky LLP, Mississauga, ON, Canada

"The structure and safeguards of composite plans will provide long-term retirement security by creating a path for employers to enter and remain in the multiemployer system, while providing the greatest possible benefits for participants."

— Randy DeFrehn, The National Coordinating Committee for Multiemployer Plans, Washington, DC

participant benefits. There are currently many traditional defined benefit plans where participants are facing massive benefit losses that could have been avoided if the plans had been empowered to adopt modest benefit adjustments years ago.

The early intervention requirements of composite plans will ensure that if a plan ever becomes severely distressed, it will make the necessary adjustments quickly before the problem is allowed to worsen. The underlying concept is that minor benefit reductions adopted by composite plans long before they become insolvent are preferable to the much larger benefit losses that occur in traditional multiemployer defined benefit plans that are at or near the point of insolvency. If plan experience improves in the future, it is generally possible to restore benefits that were reduced in the past, but once the opportunity to improve funding levels with minor benefit adjustments is missed, it is often gone forever.

From the point of view of an employer, the financial implications of a composite plan will be identical to a 401(k)-style defined contribution plan. The employer will contribute to the plan in accordance with the contribution rate contained in the collective bargaining agreement, and under no circumstances will there be any liability outside of that negotiated rate. In the event the employer ceases to contribute to the plan for any reason, there will be no withdrawal liability or other exit fee.

Current multiemployer defined benefit plans could convert to the composite model prospectively, but the composite plan provisions would not apply to benefits that participants earned prior to the conversion. This means that the benefits that participants earn going forward would not have any withdrawal liability associated with them and would be subject to the composite plan funding rules. Past benefits earned before conversion, however, would continue to be subject to both the current defined benefit plan funding requirements and withdrawal liability provisions. As newly hired workers replace the current population of active and retired participants, the legacy defined benefit plan will gradually shrink while the composite plan grows.

How Composite Plans Provide Benefit Security

Composite plans contain several features that serve to protect participant benefits. The funding rules for these plans mandate that the contribution rates and benefit levels are structured so that the plan assets are expected to reach 120% of the plan liabilities. In contrast, the funding rules for current defined benefit plans target an asset level that is 100% of the plan liabilities. Further, composite plan sponsors will be required to project the assets and liabilities 15 years into the future, and to take immediate corrective action if the plan is not on pace to reach the 120% funding target. The combination of the 20% funding cushion and the requirement for early corrective action in the event of a long-term funding imbalance will serve to ensure that composite plans are funded in a highly conservative and responsible manner, and will minimize the possibility that plans ever need to rely on the benefit adjustment provisions.

Benefit security in composite plans will also draw strength from the ability of these plans to attract and retain contributing employers. The importance of this objective can be seen in the recent experience of multiemployer defined benefit plans. The Boston College Center for Retirement Research compiled a list of the most severely underfunded multiemployer plans in the country, which they defined as plans that are expected to fully exhaust their assets in the next 15 years[1]. During the period beginning in the year 2000, and ending immediately

[1] This data was published in the Washington Post Blog on January 27, 2015. It is available at https://www.washingtonpost.com/apps/g/page/business/multi-employer-pension-plans-that-could-cut-benefits-to-retirees/1577/.

[2] The decline in the active workforce covered by multiemployer plans is based on table M-5 and M-7 from the 2013 PBGC Pension Insurance Data Tables. It is available at http://www.pbgc.gov/prac/data-books.html.

after the 2008 financial crisis, the workforce covered by the entire multiemployer system contracted by approximately 8%[2]. But, the plans that Boston College included on the list of the most distressed plans contracted by an average of 48% during this timeframe. In other words, the plans that failed to attract and retain employers in the years prior to the 2008 crisis are the same plans that are likely to experience benefit reductions after the crisis. By providing the cost predictability that employers need to remain profitable, composite plans will be able to maintain strong bases of contributing employers, which in turn provides a valuable source of benefit security to the plan participants.

Composite plans are often compared to traditional defined benefit plans, where the conventional wisdom is that participant benefits cannot be reduced under any circumstances. Unfortunately, recent history has proven that this promise is only valid as long as the plan has sufficient assets to pay full benefits, and it goes away when this is not the case. Composite plans, in contrast, recognize that a promise to pay benefits is meaningless unless the plan actually has the assets necessary to support this promise. For this reason, composite plans emphasize responsible funding policies, early intervention to address funding imbalances, and attracting and retaining contributing employers. **Composite plans will ensure that plans actually have enough money to pay benefits, instead of making promises that last only as long as the plan assets last.**

Viability of Composite Plans

The Canadian Experience: While the concepts behind composite plans are new to the retirement landscape in America, many of the underlying ideas have been used in other countries for years. This fact is most notable in Canada, where nearly all multiemployer pension plans operate under a system that shares many features with composite plans. The employers in these plans are liable only for the negotiated contribution levels, and in difficult economic times the trustees have the authority to reduce past benefits if it is necessary to maintain an adequate funding level. The experience of these plans has been enormously successful. There is an expanding base of contributing employers and the benefit adjustment authority has been rarely used, and only to the modest extent necessary to put plans on a path towards long-term health. **In fact, the system has been so successful that many in Canada are looking for ways to expand this approach outside of the multiemployer system.**

Stress Testing: In addition to considering the experience of other countries, the group of labor and management stakeholders that developed the composite plan concepts also engaged an actuarial firm to stress test the model against a variety of economic conditions. This testing found that during most economic scenarios, composite plans operated smoothly and remained in strong financial health. The analysis also showed that during severe downturns comparable to the 2008 financial crisis, composite plans have the flexibility necessary to recover without causing undue harm to either the contributing employers or the participants. The majority of composite plans would have been in a position to recover from the crisis using only negotiated contribution rate increases and prospective reductions in benefit levels. The minority of composite plans that would have also needed to adjust past benefits in order to recover would have been able to do so with modest reductions of less than 10% of participant benefits.

Conclusion

Composite plans will modernize and reinvigorate a multiemployer retirement system that has struggled in recent years. The composite plan model takes the best features of the defined benefit and defined contribution plans that are available under current law, and uses them to construct a new approach to providing employer sponsored retirement benefits. Once Congress authorizes the use of composite plans, the companies that sponsor multiemployer plans will be able to offer safe and secure lifetime benefits to their employees without risking the survival of their businesses.

***The Retirement Security Review Commission**, a working group established in 2011 and comprised of stakeholders from both labor and management, endorsed Composite Plan designs during extensive discussions on safeguarding multiemployer pension plans.*

*This White Paper on Composite Plans is presented by **"Construction Employers for Responsible Pension Reform" represented by the Associated General Contractors of America, Association of the Wall and Ceiling Industry, Finishing Contractors Association 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, and The Association of Union Constructors.***

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