TALKING POINTS: MULTIEMPLOYER COMPOSITE PLAN DESIGN

Employers that contribute to multiemployer pension plans want to continue to be able to provide lifetime retirement security for their workers but the current Defined Benefit (DB) system is unstable and employers are worried about the viability of their businesses and are being driven out of the system. The PBGC has identified several large and small DB funds on the verge of collapse. The existing economic realities mean that benefit security under the current DB system is illusory.

Labor and management came together to craft a solution which has the ability to revitalize the multiemployer system with a new type of plan called a "Composite Plan" that bargaining groups would have the option of adopting. Federal law currently allows only a traditional Defined Benefit Plan or a 401(k) style Defined Contribution Plan. Composite Plans are a hybrid plan designed to bridge the gap between the existing options. The benefit would be a lifetime benefit; it would be a variable benefit but reliable.

Employers like it, workers like it, and its use is strictly voluntary by plan trustees, which have an equal number of labor and management representatives. It would also protect the taxpayer. Because this benefit model is self-adjusting and not a defined benefit plan, it is not anticipated that this would be covered by the PBGC Multiemployer Guaranty Fund.

Positive Features from the Worker Perspective:

- **Not Mandated**: Composite Plan design is simply another tool for plans trustees to use to secure long-term retirement benefits for participants.

- **Lifetime Benefit:** Composite plan benefits would be paid as lifetime annuities – lump sums not allowed.

- **Professional Asset Management and Pooled Risks:** Plan assets would be professionally managed without the fees associated with individual accounts, resulting in far greater efficiency than is available in traditional Defined Contribution plans.

- **Benefit Security:** The flexible benefit structure would protect benefits with strict management and funding requirements – most notably plan benefits would be required to be funded at 120% -- a funding cushion of 20%. There would be safeguards against adverse market experiences and advance protections for severe market declines that would allow for modest reductions early to prevent catastrophic benefit reductions later. If the funding status improves sufficiently benefits can be restored to both actives and retirees.

- **Previously Earned Benefits Protected:** Composite Plans would apply only to benefits earned in the future; benefits already earned in the so-called Legacy Plan would not be lost nor cashed out. Transition rules would protect these earned benefits.

- **Responsible Standards:** Composite Plans rules with responsible funding policies, early intervention procedures to address funding imbalances, plus the benefit of attracting and retaining employers ensure that plans have enough money to pay benefits, instead of making promises that last only as long as the plan assets last.

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Positive Features from the Employer Perspective:

- **Cost Predictability:** Composite Plans would provide cost predictability -- employers would be required only to contribute the amount negotiated in their collective bargaining agreements and would not take on outside liabilities.

- **Labor Views Hybrid Plans as a Positive Alternative to Defined Contribution Plan**: Composite Plans are a design that workers and their labor representatives view favorably – whereas they are generally skeptical and unwilling to negotiate to a Defined Contribution plan.

- **Liabilities in Legacy Plans Gradually Diminish:** As time moves forward, liabilities in the legacy plans gradually diminish as benefits are paid out and participants earn accruals in the new plan.

- **Companies Continue to Provide Good Jobs within a Community:** With a Composite Plan in place, instead of closing their doors, large and small employers would be able to manage their risk, feel confident about passing their business on to their children or other family members or have the viable option to sell their businesses when they retire because the overwhelming burden of uncontrollable, unknowable risk of unfunded liabilities is removed.

- **Private Sector Solution:** The proposal is a private sector solution, not requiring government dollars and is designed to keep the current funding crisis from happening in the future.

- **Retain and Attract Employers:** By eliminating unfunded liabilities (withdrawal liability) for employers going forward, the composite design would improve the ability of plans to retain existing contributing employers and would remove a significant barrier for attracting new employers.

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Positive Features from the Actuarial Perspective:

- **Provisions that Protect Participant Benefits:** The Composite Plan model pays benefits in the same manner as current Defined Benefit Plans, while recognizing that those benefits must ultimately be equal to the financial resources of the plan. Since this means that benefits could need to be reduced during difficult financial times, the Composite Plan model contains several features that serve to protect participant benefits:

    - The funding target for these plans is equal to 120% of the actuarial liability, with the 20% cushion providing a reserve against adverse experience.
    - In the event a shortfall develops, the bargaining parties have the opportunity to allocate additional contributions to shore up funding levels, and if necessary, the trustees are required to adopt reasonable reductions to future benefit accruals and ancillary benefits.
    - The trustees of a Composite Plan are required to create and implement a recovery program immediately when a long-term imbalance arises, ensuring that the problem does not have an opportunity to grow unchecked.

- **Sharing of Risks:** Composite Plans manage investment risk in much the same way that a health insurance plan manages the financial risk of someone becoming gravely ill. The insurer knows that some people will require expensive medical care, but does not know which people, so the premiums for everyone include an allowance for this cost. In the absence of such an arrangement each person would bear the financial risk of their health, which would benefit people who do not get sick and bankrupt those who do.

    Similarly, the sponsor of a Composite Plan knows that the financial markets will experience declines, but does not know when, so all contributions include a 20% allowance over the anticipated costs as a buffer against the inevitable down markets. Composite Plans further distribute this risk by allowing sponsors to adopt modest decreases in the rate of future benefit accrual as a way to respond to adverse experience. These mechanisms represent a reasonable and appropriate sharing of risk across the participant population, just as a health insurance plan shares risk across its population.

- **Benefit Levels in Composite Plans Highly Resilient** – A stress-testing analysis has been performed that shows how the 2008 market crash in which the S&P 500 Index lost 37% of its value in a single year would have impacted a typical Composite Plan. In order to be as pessimistic as possible, this stress testing scenario assumed no recovery in the markets following the decline, which is far worse than actually happened, and also included a 25% contraction of the economic base supporting the plan. In this situation, the Composite Plan was able to recover without imposing any reductions on retired participants aside from cuts to subsidized early retirement benefits and other ancillary plan features. This analysis illustrates how Composite Plans are able to stand up to dramatically poor experience without needing to impose unreasonable sacrifices on participants.

- **No Empty Promises:** There is a clear relationship between risk and return in the financial markets. Composite Plans are designed to accept a moderate level of risk in order to provide higher benefits at lower cost than could be achieved in a system that invests only in risk-free assets. Composite Plans explicitly acknowledge that taking risk means benefit levels are not guaranteed. The design has sophisticated mechanisms that mitigate the possibility of benefit decreases, and these mechanisms have been shown to be very effective. But it is impossible to predict the magnitude of adverse financial events that can occur, and Composite Plans recognize that it is possible that benefits could be reduced in the future. In fact, once it is clear that the various safeguards are insufficient to offset a catastrophic economic downturn, the sponsor of a Composite Plan is required to immediately adjust benefits to a sustainable level. Taking prompt action will ensure that the imbalance is corrected with the smallest possible reductions.

- **Clear Advantage Over 401(k) Plans:** Both Composite Plans and 401(k) Plans involve the same underlying financial risks, and under both approaches it is the participants who bear those risks. The difference is that in a 401(k) Plan participants bear those risks individually, while in Composite Plans they bear them as a group. In addition to the sharing of investment risk discussed above, Composite Plans also share longevity risk among participants by paying each retiree an annuity instead of a lump sum. While it is impossible to accurately predict how long any one participant's retirement will last, it is possible to predict with a high degree of accuracy how long the average retirement over a large population will last. Composite Plans use this information to pay retirement benefits over participants' retired lifetimes, ensuring that no retiree or surviving spouse outlives his or her retirement benefits, which is a problem that plagues the 401(k) system.

- **Expected Rates of Return Reasonable -** Since 1928 a balanced portfolio invested 50% in the S&P 500 Index and 50% in 10-year Treasury bonds has returned an average of 7.8% annually. Despite the recent financial turbulence, the 30-year trailing average of this portfolio is currently above 9%. Looking forward, a 2015 Horizon Actuarial Services survey of the asset return expectations of 29 different investment advisors concluded that a well-diversified portfolio is expected to earn between 7% and 7.5% average annual investment returns over a 20-year time horizon. Actuaries typically anticipate that multiemployer plan assets will, on average, produce returns from within this range. Both historical data and the current capital market models used by professional investment advisors demonstrate that this is a reasonable expectation. While there is no guarantee of future investment returns, the rates of return that would be used to establish contribution and benefit budgets in Composite Plans are reasonable in light of past experience and future expectations.

Conclusion

Composite Plans will modernize and reinvigorate a multiemployer retirement system that has struggled in recent years. Once Congress authorizes the use of Composite Plans, labor and management will have the option to elect a plan design that would provide a safe and secure lifetime retirement benefit to employees without risking the survival of a sound business that offers good middleclass jobs with important benefits for workers and society.