

Investing Special Financial Assistance Funds—Now What?

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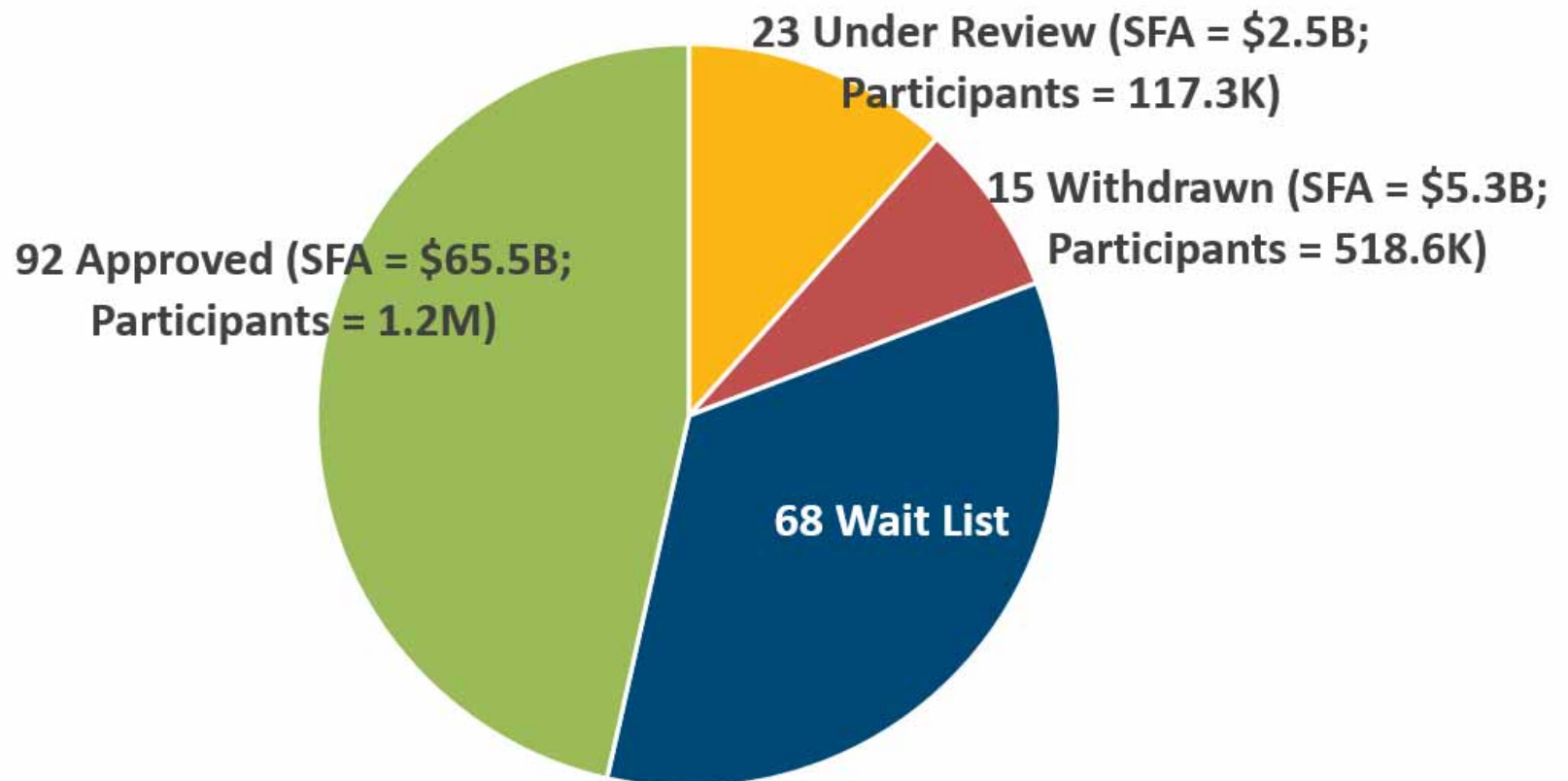
Topics

- Primer on Special Financial Assistance (SFA)
- Regulatory requirements and trending options
- Investment considerations for SFA and legacy assets
- Risk management
- Audit requirements

Primer on SFA

- Special Financial Assistance (SFA) program was created by the American Rescue Plan Act of 2021
- Saves roughly 200 distressed multiemployer pension plans covering 2 million participants from insolvency
- Restores the financial condition of the PBGC's multiemployer program that was previously projected to be insolvent in 2025
- The amount of SFA is generally determined to pay full benefits through the plan year 2051

Primer on SFA



Source: From PBGC Application Status Tracker as of 9/27/2024

Primer on SFA

- SFA determined using two separate interest assumptions: Legacy Assets, SFA Assets

Asset	Requirement *	12/31/2022 Lock-In
– Legacy	3 rd Segment Rate + 2%	5.85%
– SFA	Average of the three segment rates plus 0.67%	3.77%

Surpassing these rates could increase the likelihood of achieving solvency beyond 2051

** Not greater than pre-2020 assumption*

Regulatory Requirements and Trending Options

Regulatory Requirements

- SFA must be segregated from legacy assets and only used to pay benefits and expenses
- SFA asset allocation
 - Up to 33% may be in return-seeking investments (publicly traded common stock)
 - At least 67% is restricted to high-quality (investment grade) fixed income investments
- Legacy asset allocation
 - Plan's discretion

Regulatory Requirements

Permissible Investments

What do terms like "investment grade," "fixed rate," "debt security," "leverage," and "common stock" mean in the context of permissible investments for SFA?	+
Will PBGC identify whether a particular asset class, sub-asset class, fund structure, or investment strategy is permissible before a plan invests?	+
What are some examples of permissible investment grade fixed income securities?	+
What is an IGFI permissible fund vehicle?	+
What are some examples of permissible return-seeking asset securities?	+
What is a return-seeking asset permissible fund vehicle?	+
What is a "Rule 144A" security? How are "Rule 144A" debt securities, which are permissible RSA under the SFA regulation, different from private credit, which isn't a permissible investment?	+
When does the 33 percent limit on RSA apply?	+
What does "predominantly" mean in the context of the type of permissible fund vehicles SFA assets may be invested in?	+

Last Updated: July 16, 2024

Source: <https://www.pbgc.gov/arp-faqs>

Trending Options

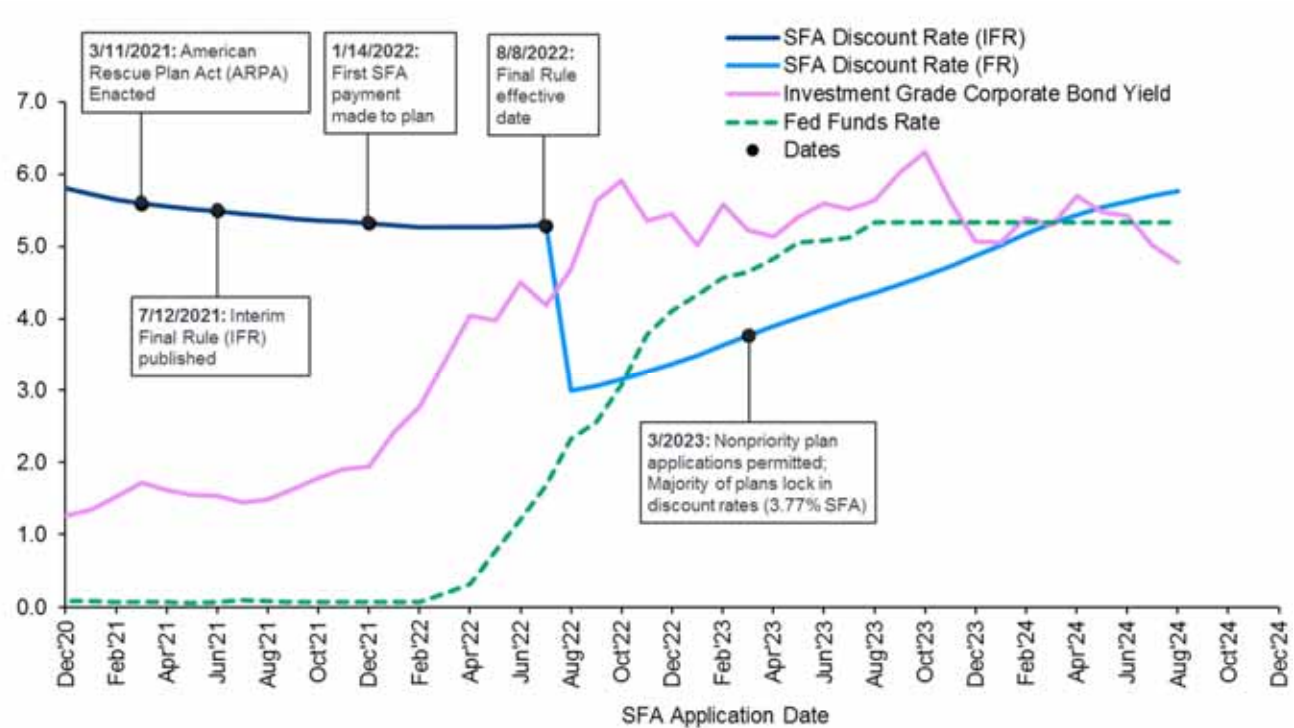
- SFA investment options will depend on:
 - Trustees' risk preference
 - Amount of SFA
 - Period SFA drawn down.
- Options
 - Immunization
 - Cash matching
 - 100% fixed income
 - 67% fixed income, 33% return-seeking



Investment Considerations for SFA and Legacy Assets

Rules and Markets Evolved Dramatically

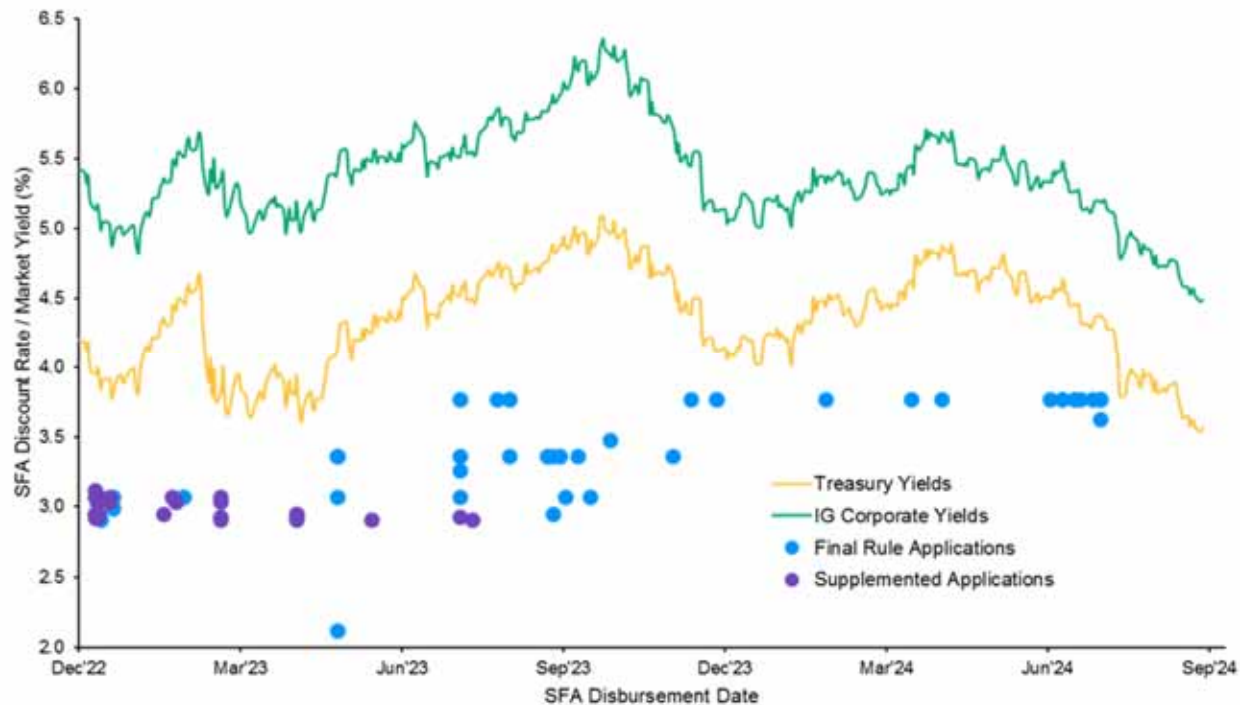
SFA Rate Limit vs. Investment Yields



Source: JPMorgan Asset Management, BAML ICE, IRS, Federal Reserve, PBGC. Data of Aug 31st, 2024. Investment Grade Corporate Bond Yields modeled as ICE BofA 1-10 Year US Corporate Index.

SFA Discount Rates Historically Below Treasuries

SFA Discount Rate vs. market yields at the time of disbursement of SFA funds

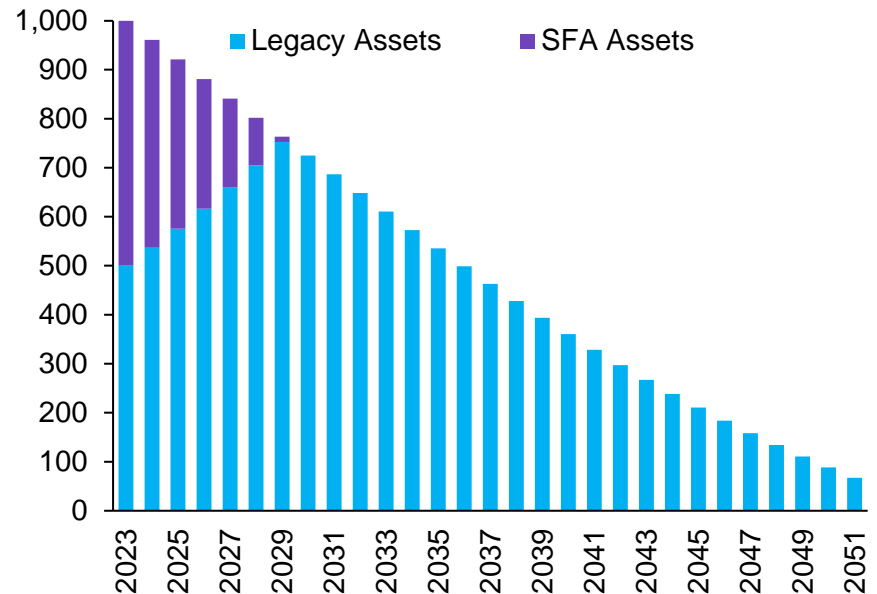
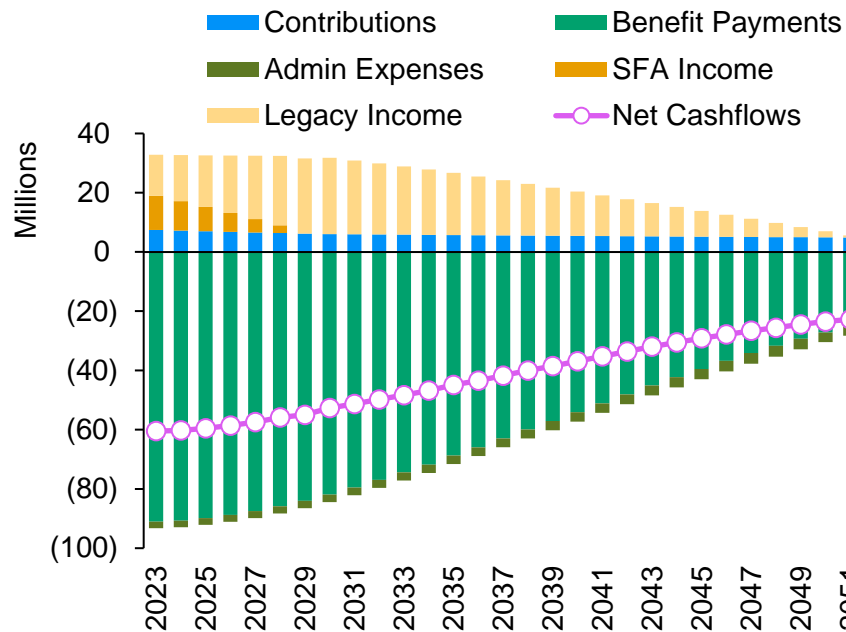


Source: J.P.Morgan Asset Management, PBGC, BAML. Treasury yields represented by ICE BofA 1-10 Year US Treasury Index. Investment grade corporate yields represented by ICE BofA 1-10 Year US Corporate Index. Data as of 9/13/2024.

Sample Application

Plan is Cashflows: 5.85% Legacy/
3.77% SFA

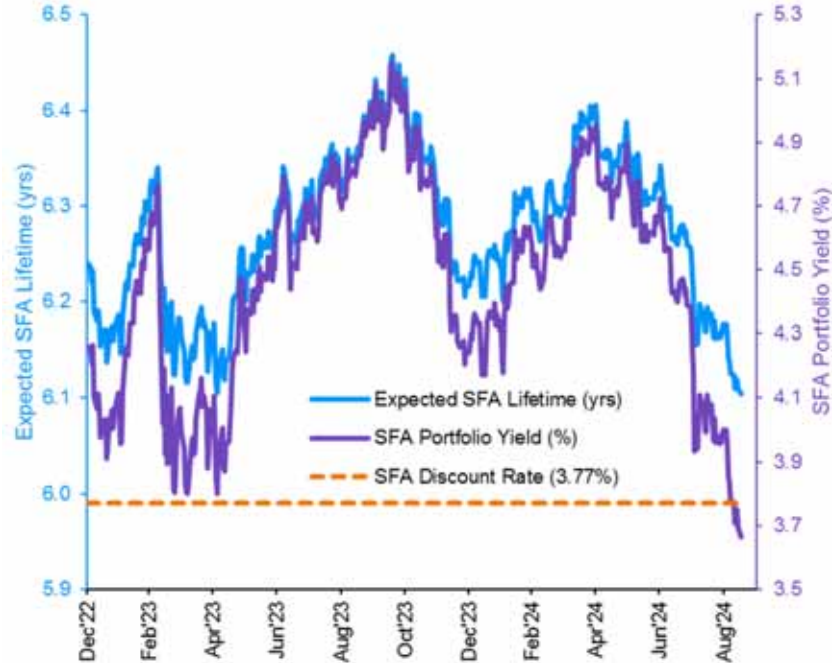
SFA Expected to Deplete in 2029



Source: J.P. Morgan Asset Management, For Illustrative Purposes Only.

Case Study: SFA Lifetime Related to Market Yields

Historical SFA Expected Lifetime and Treasury Ladder Yield



Treasury Ladder purchased 8/31/2024

JPM270 SFA Portfolio Characteristics

SFA Discount Rate (%) 3.77

Portfolio Yield (%) 4.00

Expected Lifetime (yrs) 6.2

Source: J.P.Morgan Asset Management, Data as of September 13th, 2024

Plans Awaiting SFA Funds Are Exposed to Rate Risk

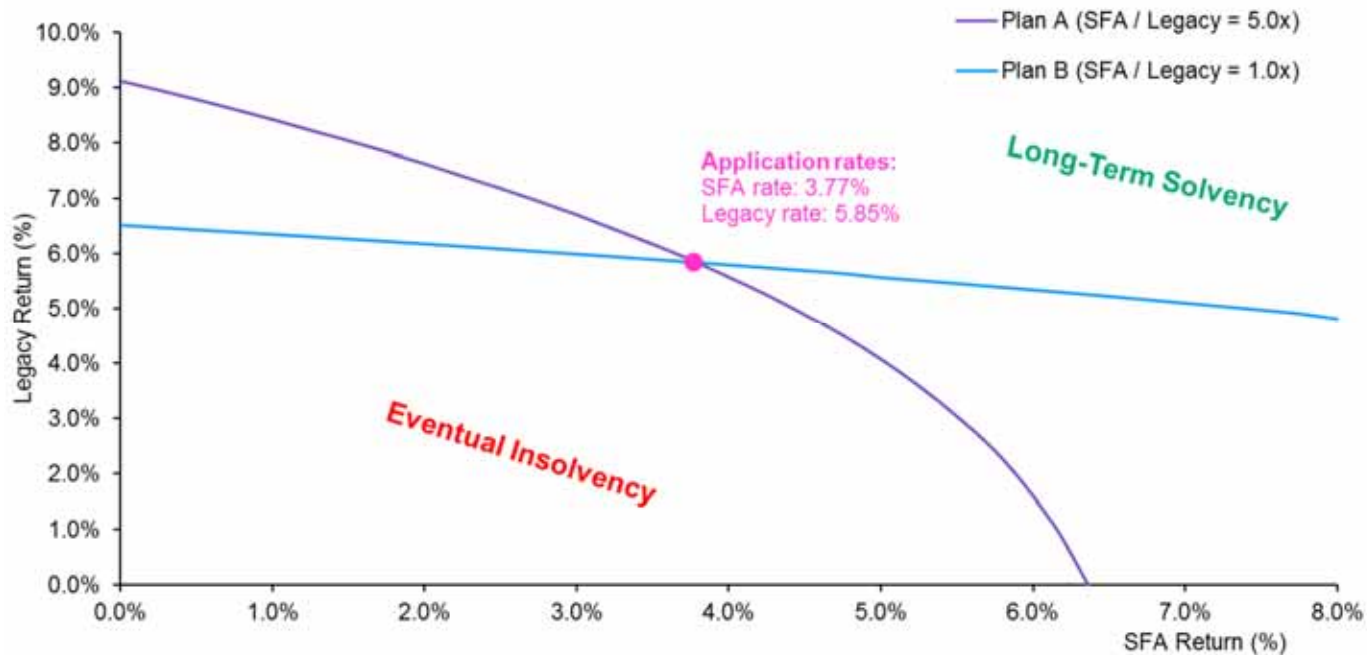
Impact of rising or falling interest rates on SFA awards of varying expected lifetimes before depletion

Ladder Expected Lifetime	5 Years	10 Years	15 Years
SFA Award (\$mm)	100.0	100.0	100.0
SFA Duration (yrs)	5.0	9.2	12.7
Cashflows Purchased (\$mm)	110.3	120.1	130.4
Income Generated (\$mm)	10.3	20.1	30.4
1% Decline in Interest Rates between measurement and investment date			
Δ Income Generated (\$mm)	(2.9)	(6.3)	(10.4)
Δ Ladder Lifetime (yrs)	(0.1)	(0.6)	(1.5)
1% Rise in Interest Rates between measurement and investment date			
Δ Income Generated (\$mm)	+3.1	+5.6	+14.0
Δ Ladder Lifetime (yrs)	+0.1	+0.7	+2.0

Source: J.P. Morgan Asset Management, Data as of August 31st, 2024

Plans With Relatively Larger SFA Pools Will Benefit More From SFA Return Enhancement

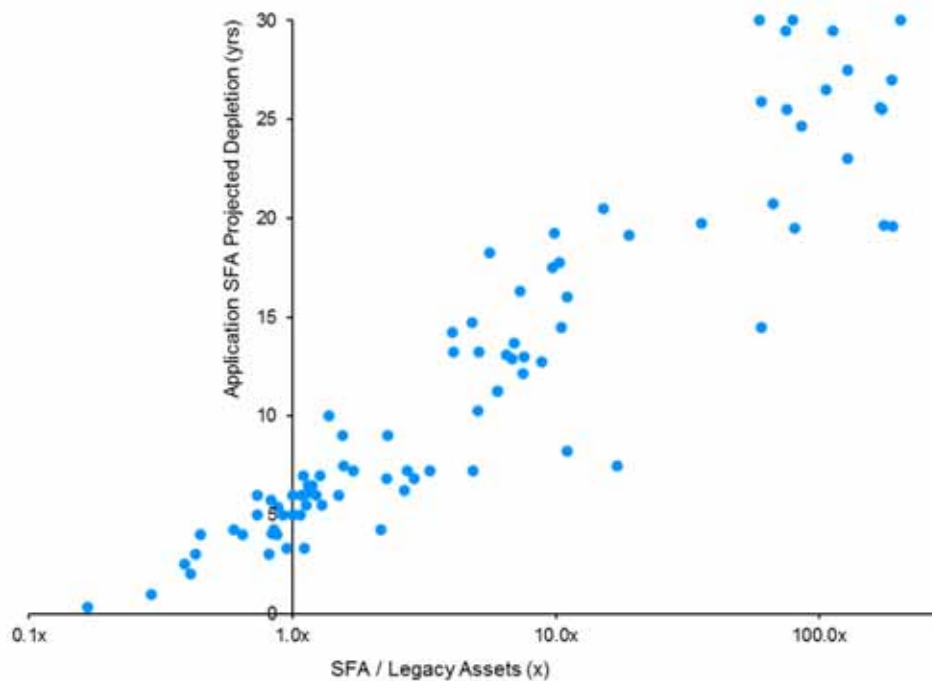
SFA and Legacy Asset Return Needed to Reach Year Thirty



Source: J.P. Morgan Asset Management, PBGC SFA Application Website, Data as of August 31st, 2024

SFA Lifetime Closely Related to Relative Size

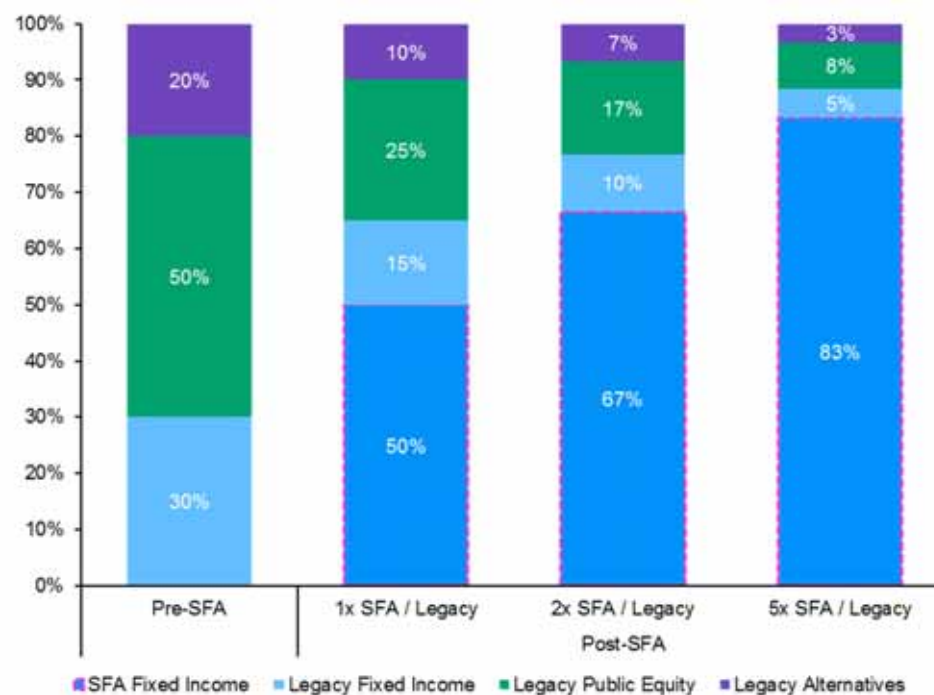
Application expected depletion versus SFA/Legacy assets ratio



Source: J.P.Morgan Asset Management, SFA applications on PBGC website. Data as of 9/13/2024.

SFA Funds Boost Total Portfolio Fixed Income

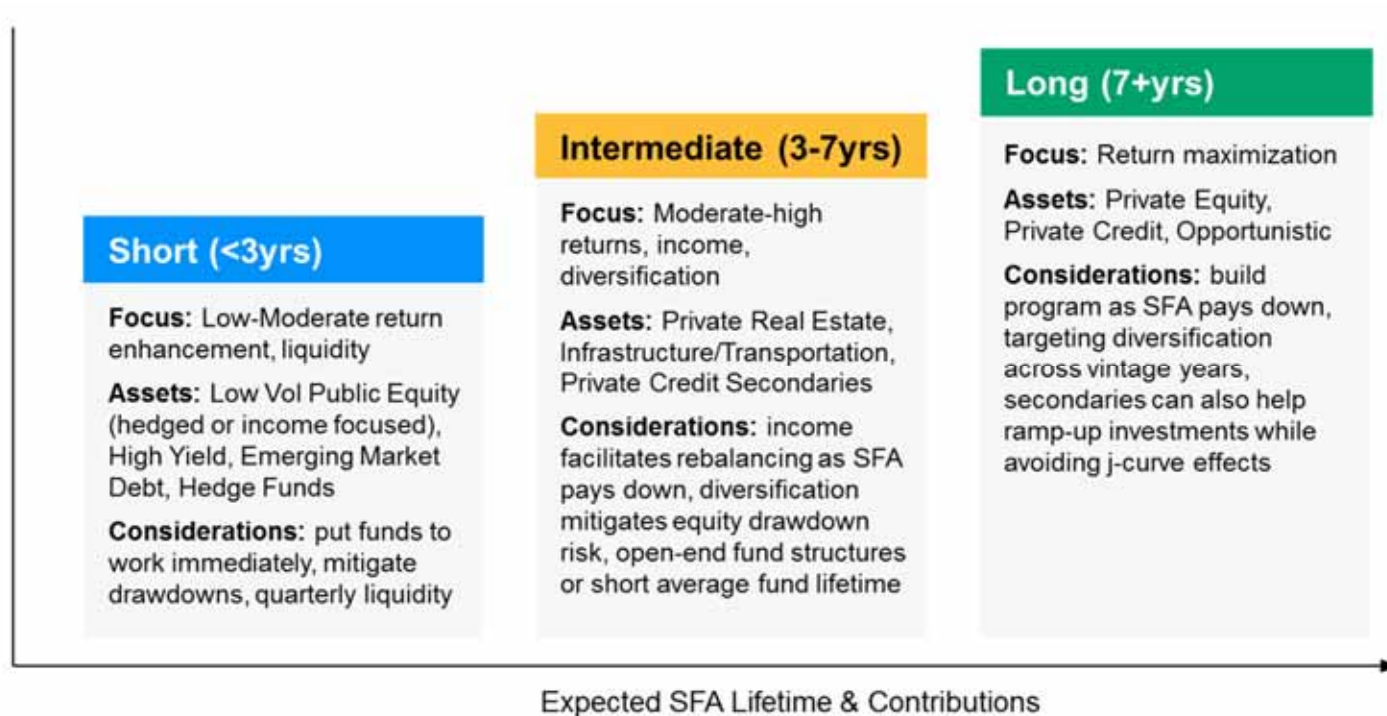
Total portfolio allocations pre- and post-SFA for different size SFA/Legacy asset ratios for a hypothetical plan



Source: J.P. Morgan Asset Management, Data as of August 31st, 2024

Liquidity Preservation Versus Return Maximization

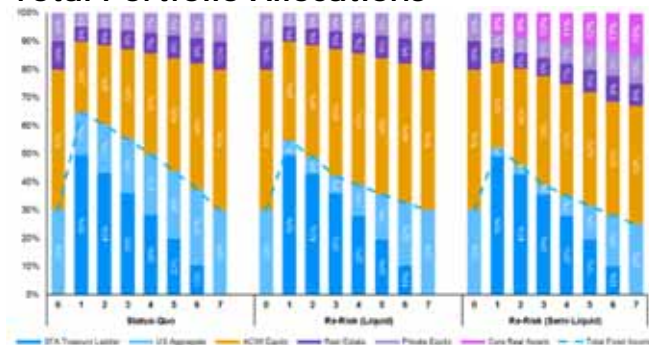
Considerations for legacy asset allocation changes



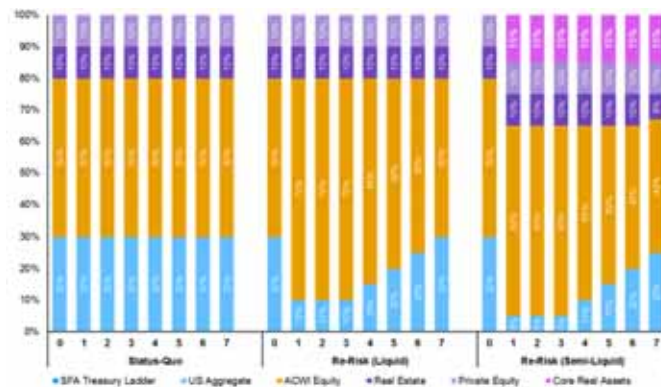
Source: J.P. Morgan Asset Management, Data as of August 31st, 2024

Case Study: Rethinking Legacy Portfolio

Total Portfolio Allocations



Legacy-Only Allocations



Source: J.P. Morgan Asset Management, Data as of August 31st, 2024

- 1) **Status-Quo:** Continue running legacy assets with same allocation alongside depleting SFA pool.
- 2) **Re-Risk (liquid):** 20% of legacy portfolio re-allocated from bonds to public equity. As SFA depletes core bond is reconstituted to arrive at 30% target in year 7.
- 3) **Re-Risk (semi-liquid):** 25% of portfolio re-allocated from core bonds, 10% to public equity and remaining 15% to core income-oriented real assets. At end of depletion period, portfolio continues with elevated 35% in alternatives.

Case Study: Balancing Return Enhancement and Diversification

Comparison of total plan simulated results

	Status-Quo	Re-Risk (Liquid)	Re-Risk (Semi-Liquid)
<i>10 -Year Metrics</i>			
Average Funded Status	116.5%	123.0%	126.5%
Median Funded Status	110.0%	114.1%	117.8%
5th%ile Funded Status	57.2%	52.3%	58.5%
Probability last more than 10yrs	100.0%	100.0%	100.0%
<i>30 -Year Metrics</i>			
Probability last more than 30yrs	76.0%	75.7%	80.9%
5th%ile % of benefits/expenses paid	73.8%	70.3%	75.0%

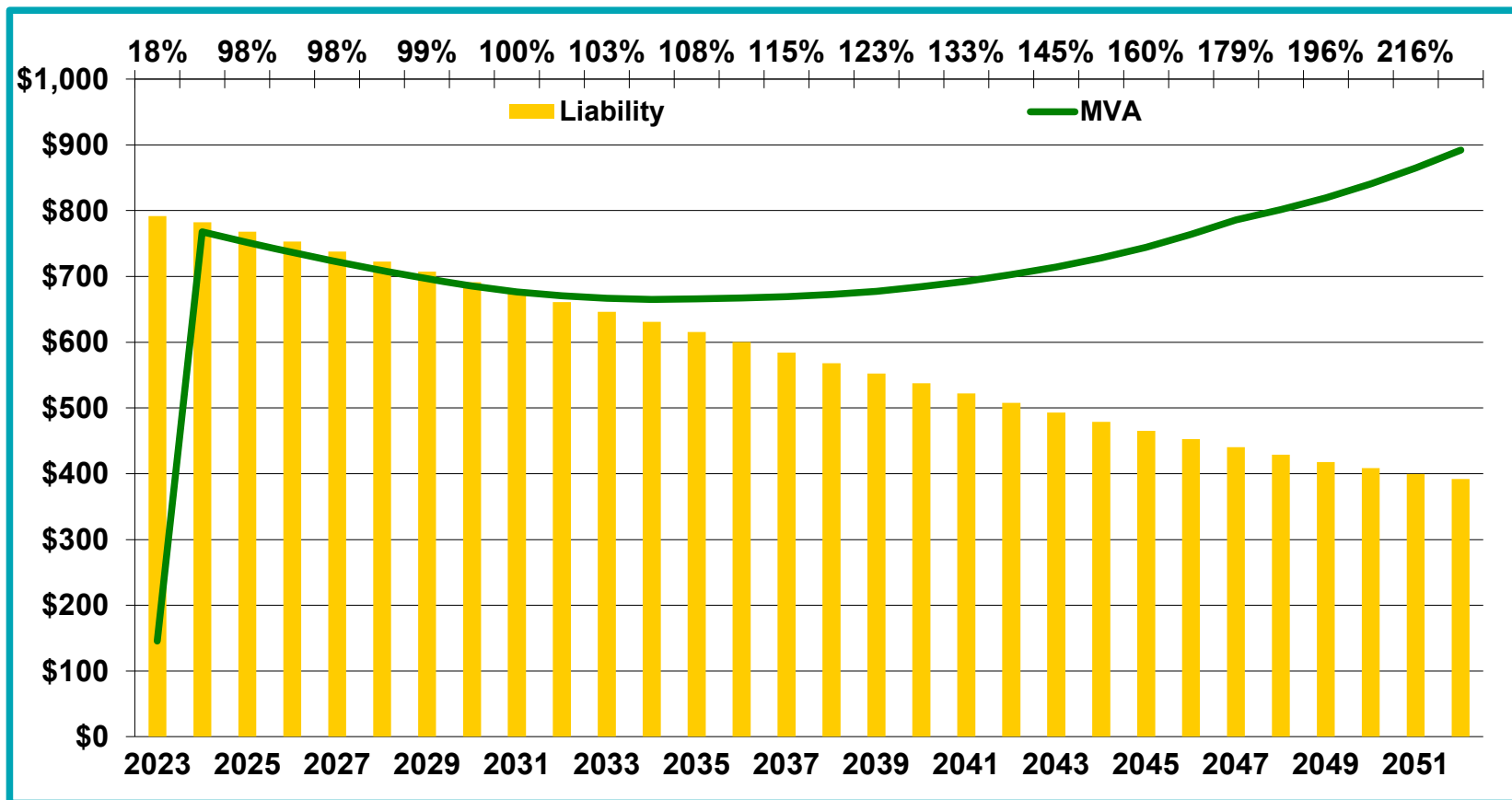
Source: J.P. Morgan Asset Management. Simulation based on 5,000 economic scenarios with a start date of 8/31/2024. Liability valuation utilizes a discount rate of 6.00%

Risk Management

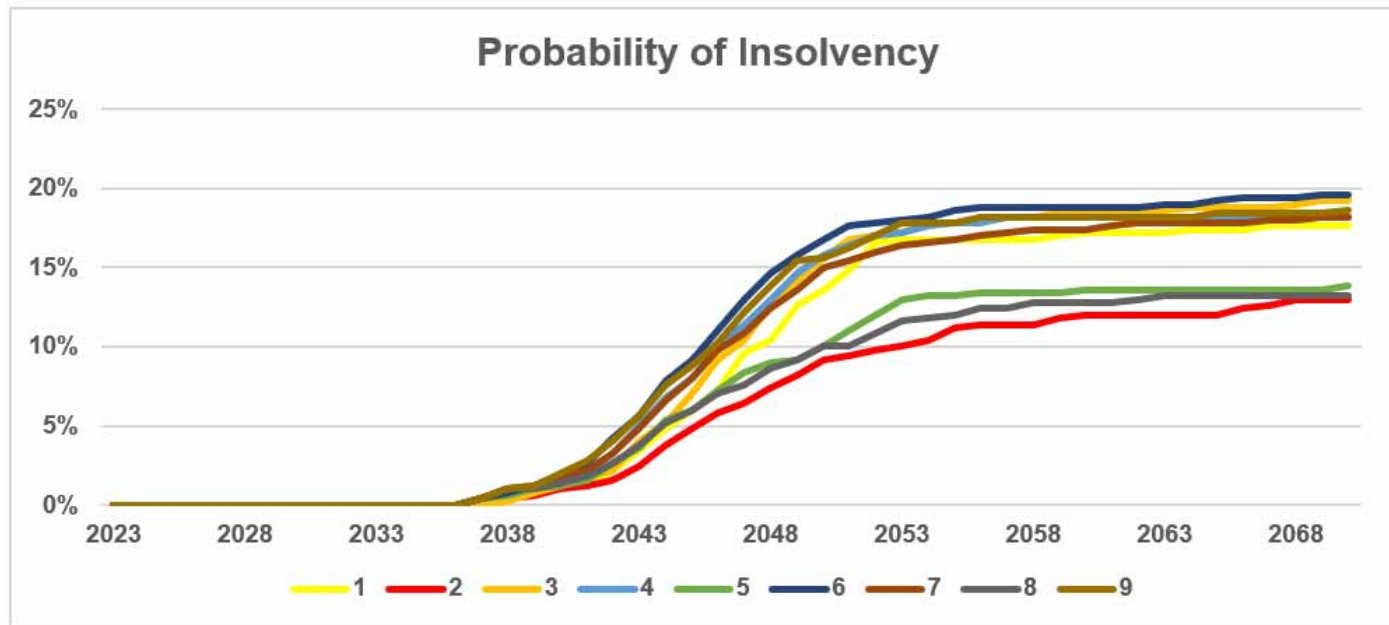
Risk Management

- Work with your plan actuary to analyze asset portfolios under consideration
- Actuary can perform stochastic analysis to show the inherent risks

Risk Management

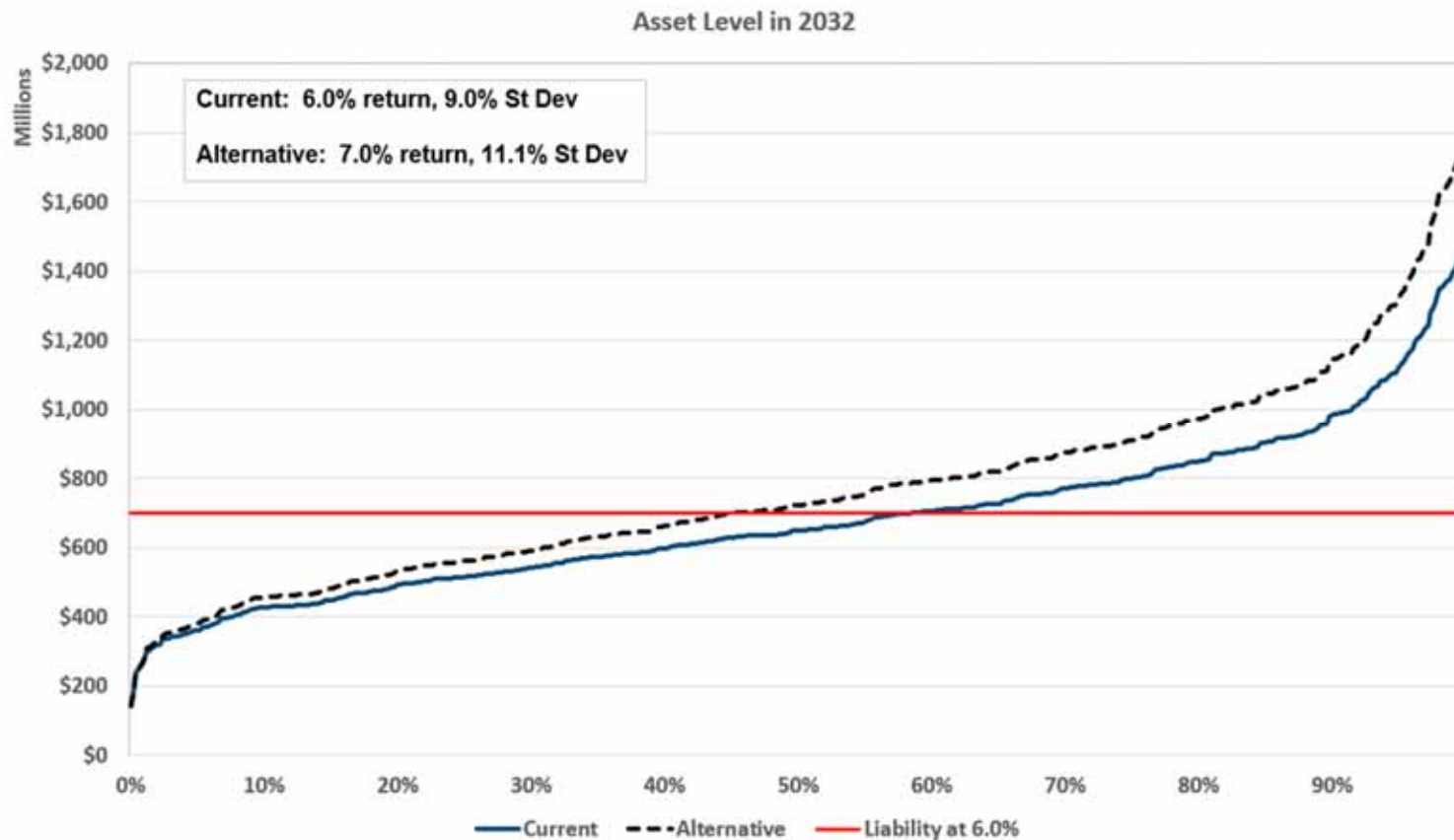


Risk Management



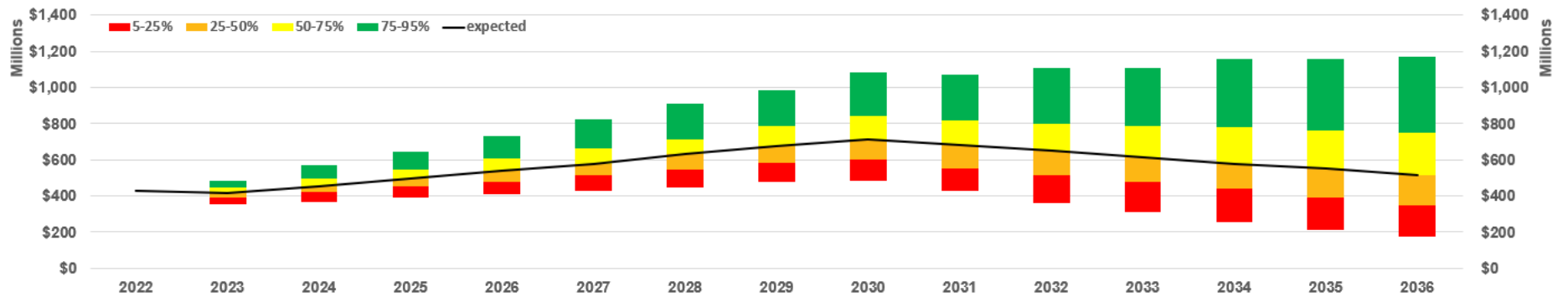
Scenario	1	2	3	4	5	6	7	8	9
Legacy Return	7.2%	7.2%	7.2%	7.8%	7.8%	7.8%	8.1%	8.1%	8.1%
Legacy St Dev	10.8%	10.8%	10.8%	14.0%	14.0%	14.0%	14.8%	14.8%	14.8%
SFA Return	4.8%	5.7%	4.5%	4.8%	5.7%	4.5%	4.8%	5.7%	4.5%
SFA St Dev	5.0%	8.5%	4.5%	5.0%	8.5%	4.5%	5.0%	8.5%	4.5%

Risk Management

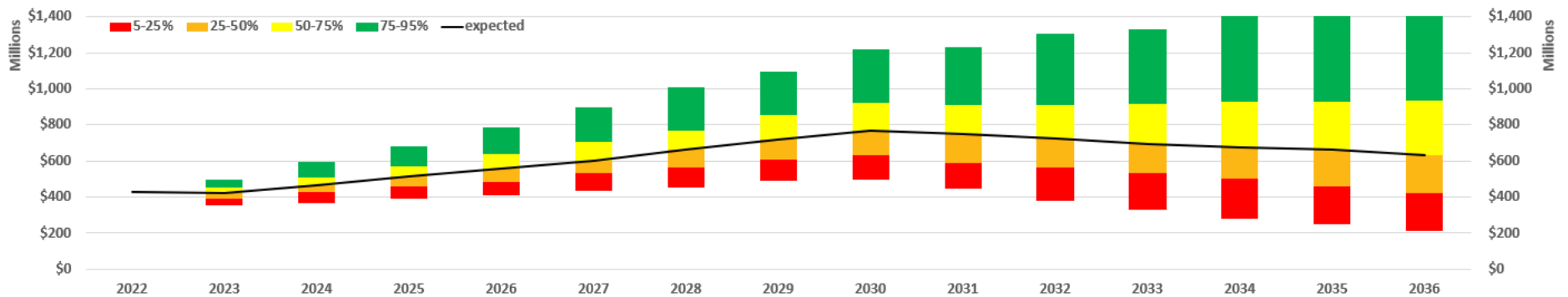


Risk Management

Current (6.0% Return, 9.9% St Dev)



Alternative (7.0% Return, 11.1% St Dev)



Audit Requirements

Audit Requirements (Annual Compliance)

- Must file with PBGC annually beginning with the plan year in which SFA was paid through the last plan year ending in 2051
- Filed no later than 90 days after the end of the plan year (file earlier if 90th day falls on holiday/weekend)
- No statement of compliance due if SFA paid in the last 6 months of the plan year
- Signed by trustee or authorized representative of the plan sponsor
- <https://www.pbgc.gov/sites/default/files/documents/annual-statement-compliance.pdf>

Audit Requirements (Annual Compliance)

- Part I: Plan Information
- Part II: Compliance with restrictions and conditions (not merged plans)
- Part III: Compliance with restrictions and conditions (merged plans)
- Part IV: Compliance with requirement to reinstate benefits and pay make-up payments
- Part V: Required documents
- Part VI: Certification

Audit Requirements (Annual Compliance)

- Required documentation
 - Most recent audited financial statements
 - Most recent actuarial valuation report
 - Plan document and recent amendments
 - Account statements (banks and investment accounts)
 - SFA Investment Allocation (excel worksheet)
 - Most recent zone certification
 - Updated Template 4A through SFA projection period or insolvency
 - Other as requested by PBGC

Key Takeaways

- Relief recipients can benefit by taking a holistic approach to investing SFA and legacy assets
- Plans receiving SFA distributions have historically been able to outperform discount rates with low-risk treasury bonds
- As rates come down, future recipients should consider investment grade credit, securitized and potentially RSAs
- Work with plan actuary on stochastic projections to understand risks before finalizing your investment strategy

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