Post–Special Financial Assistance—Keeping Your Plan Solvent

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International Foundation OF EMPLOYEE BENEFIT PLANS

SFA Program Update

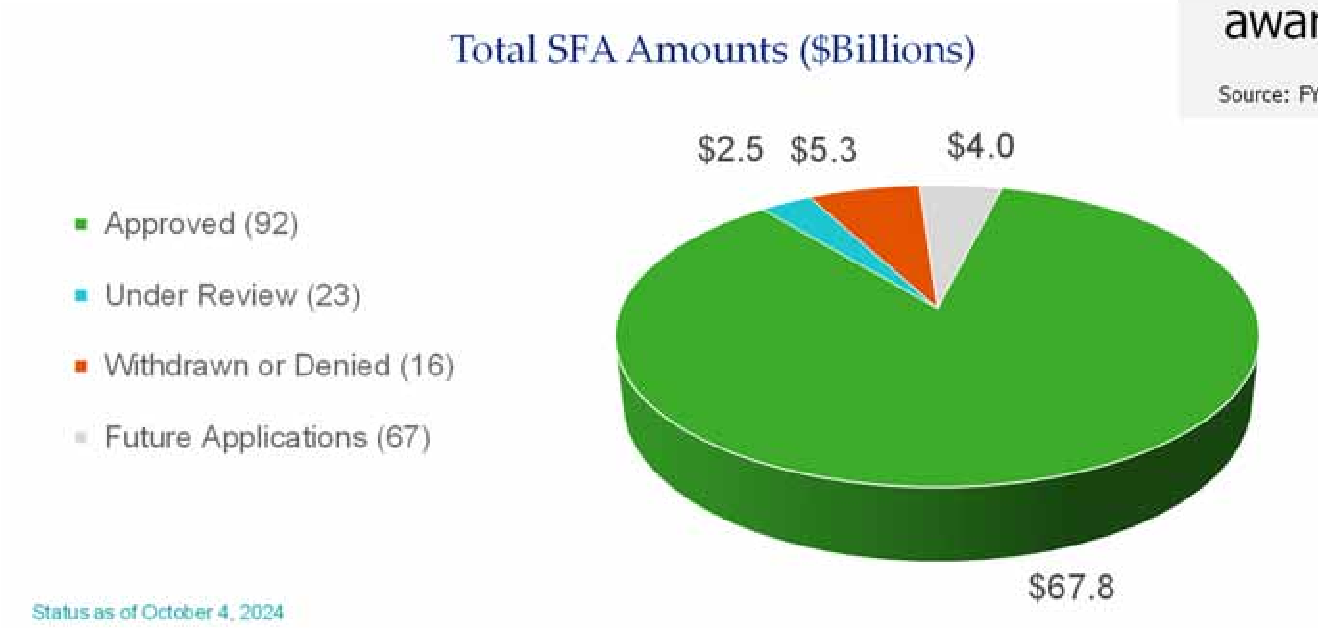
Introduction

- Special financial assistance (SFA)
  - Established under American Rescue Plan Act of 2021
  - For eligible multiemployer pension plans
  - Targets solvency through 2051
  - Administered by Pension Benefit Guaranty Corporation
- PBGC regulations
  - Interim final rule issued on July 9, 2021
  - Final rule issued on August 8, 2022

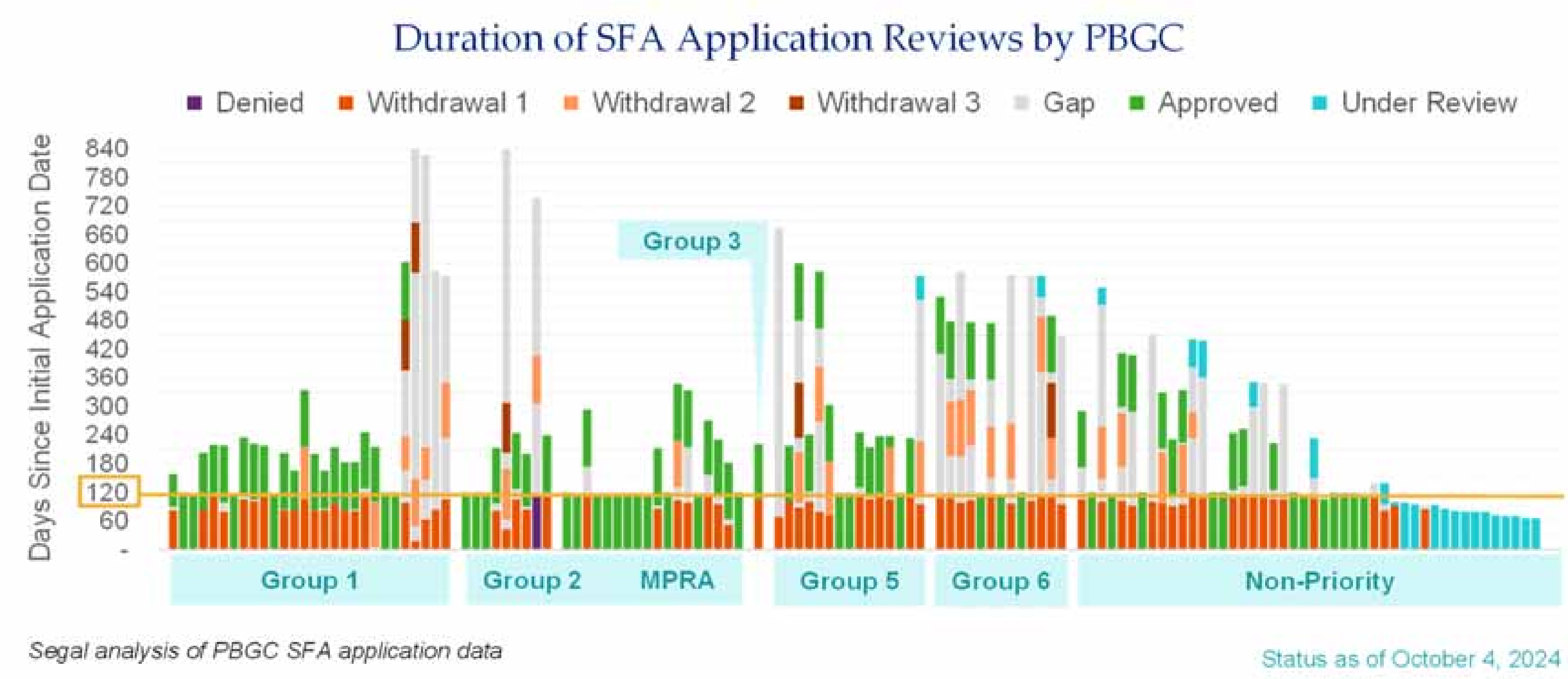
SFA Awards to Date

PBGC estimates total SFA awards of **$79.6 billion.**

Source: FY 2023 Projections Report (published July 2024)



How Long Is PBGC Taking to Review?



Lock-In Applications

- 112 plans have submitted lock-in applications
  - 103 locked-in measurement date at December 31, 2022
- Locks in base data
  - Measurement date
  - Census data
  - Interest rates

Waiting List

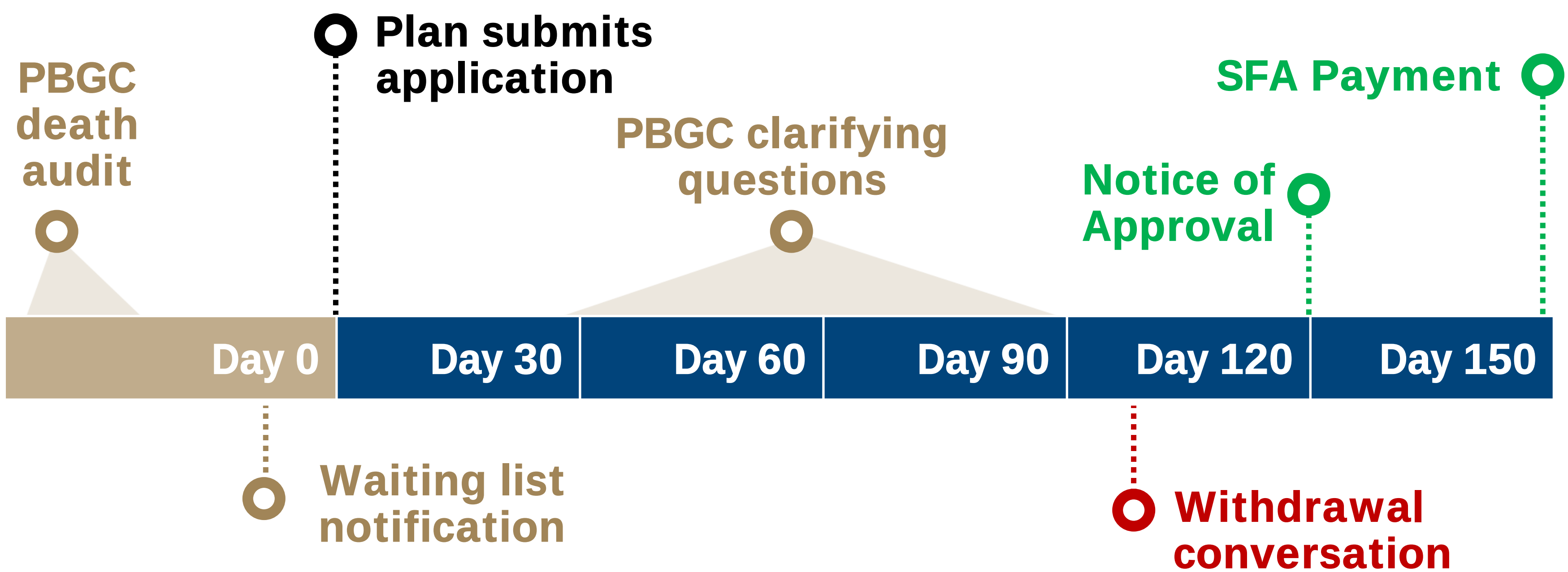
- PBGC metering mechanism
  - Must comply with statutory 120-day review period
  - Allow remaining plans to apply as capacity permits
- As of October 4, 2024:
  - 115 total plans on waiting list
  - 49 of these plans have applied
  - Remaining 66 are still waiting

Death Audits

- PBGC Office of Inspector General (OIG)
  - Initial report—March 2023
  - Final report—September 2023
- House Committee on Education and Workforce
  - “GHOST” Act—January 2024
  - Committee hearing—April 2024
- Repayments of excess SFA amounts
  - Central States repays $127 million (DOJ)—April 2024
  - Other plans repaying excess amounts (PBGC)—Ongoing

PBGC Review: Timeline

Timeline is illustrative, approximate



Post-SFA Compliance

Compliance Rules

- Conditions under §4262.16 of final rule
  - Restrictions on benefit increases
  - Restrictions on contribution rate reductions
  - Restrictions on allocation of contributions
  - Restrictions on investments
  - Mergers and transfers
  - Withdrawal liability

SFA Rules on Investments

- Segregate SFA assets from other assets
- Use SFA assets only to pay benefits and administrative expenses
- SFA assets limited to not more than 33% in return-seeking assets
- Total plan assets must include investment grade bonds to cover at least 1 year of benefit payments and administrative expenses

PBGC FAQs

- Permissible investments
  - Common definitions (e.g., “investment grade”)
  - PBGC will review with statement of compliance (not in advance)
  - Examples of permissible investments
    - Investment grade fixed income, vehicles
  - Return-seeking assets, vehicles
  - Permissible assets under SEC Rule 144A
  - Application of 33% rule
  - Meaning of “predominantly”

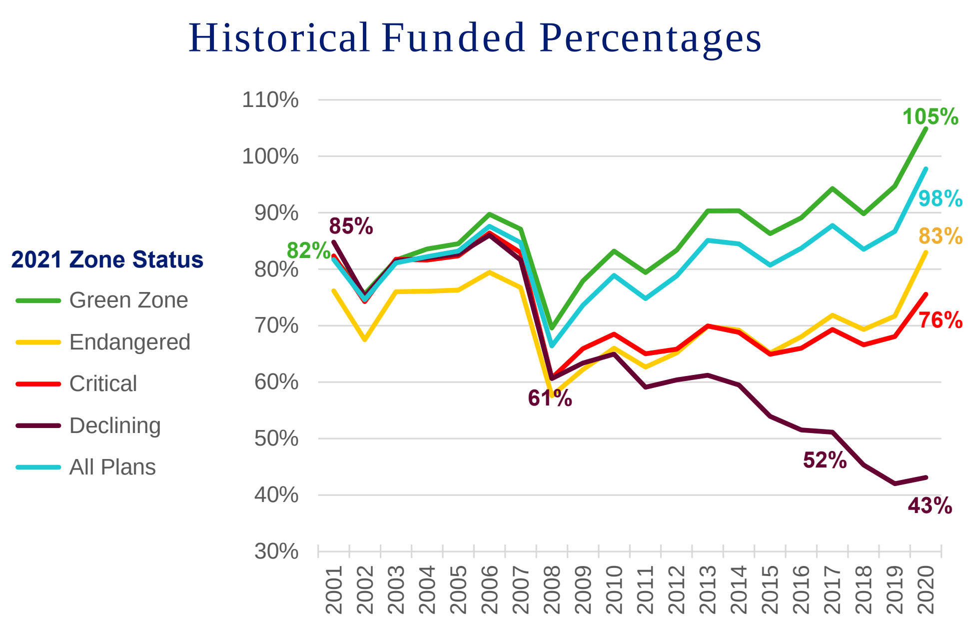
https://www.pbgc.gov/arp-faqs

Annual Statement of Compliance

- Due 90 days after close of plan year
- First statement is required for a plan year in which the plan had SFA for at least 6 months
- Demonstrates compliance with §4262.16
  - Must be completed in **PBGC e-filing portal**
  - Must include various attachments
  - Most documentation around permissible investments

Importance of Plan Maturity

How Did We Get Here?



Study of Form 5500 data by Segal. Graph shows median funded percentages based on market value of assets at plan year end. Plans are grouped by 2021 zone status.

Observations

- In 2001, not much dispersion in median funded percentages
- Over last 20 years, funding for plans in **critical and declining** status deteriorated rapidly
- In 2001, plans currently in **critical and declining** status had a slightly higher median funded percentage than plans currently in the **green zone**

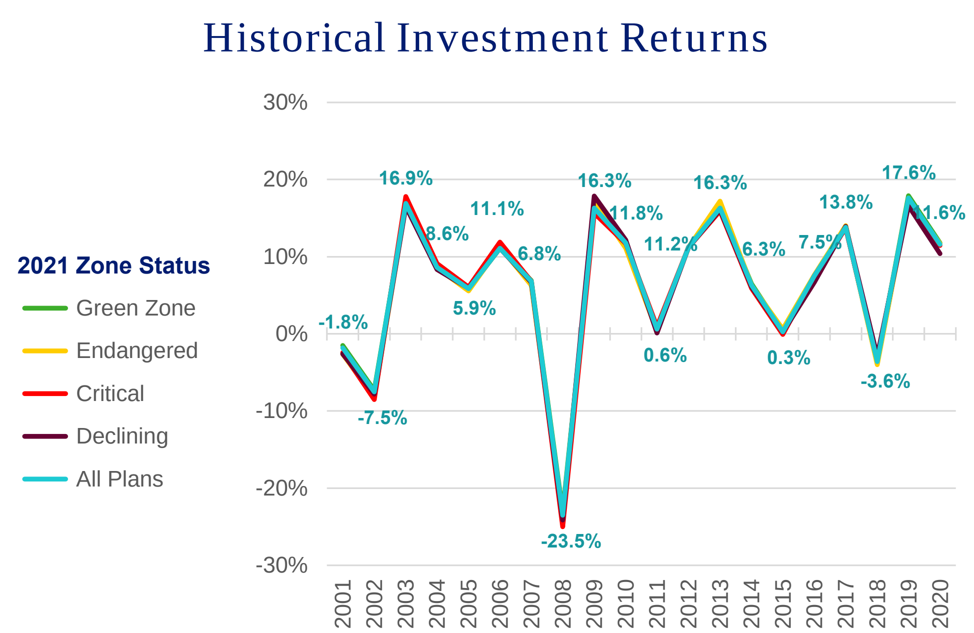
Investment Returns

There is little difference in historical investment returns by zone status.

Annualized Investment Returns

2021 Zone Status	2001-2015	2001-2020
Green Zone	4.8%	5.9%
Endangered	4.6%	5.7%
Critical	4.5%	5.6%
Declining	4.6%	5.6%
All Plans	4.7%	5.8%

Study of Form 5500 data by Segal. Exhibit shows cumulative net investment returns for calendar year plans. Plans are grouped by 2021 zone status.



Study of Form 5500 data by Segal. Graph shows calendar year net investment returns. Plans are grouped by 2021 zone status.

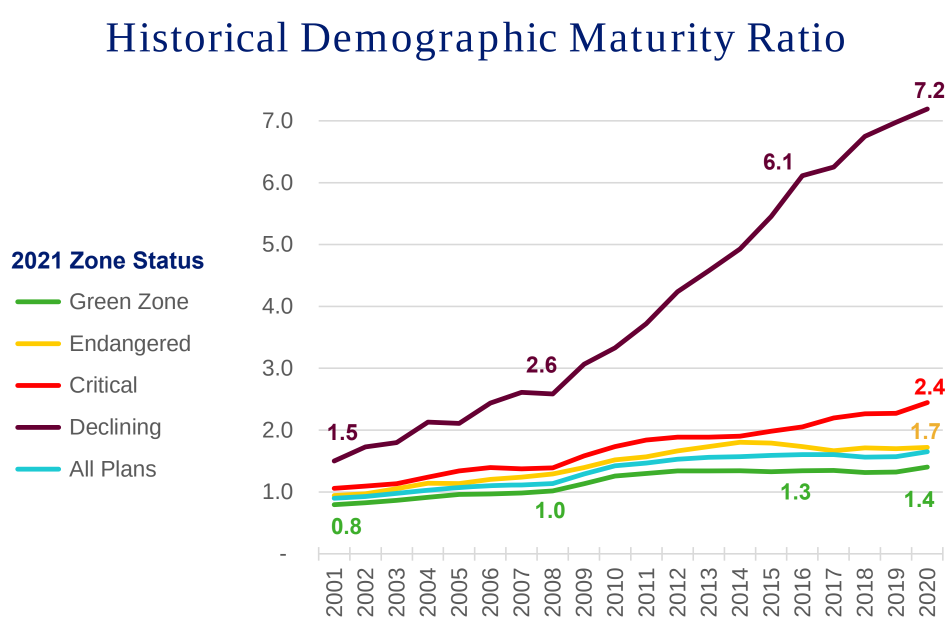
Contribution Rate Increases

Cumulative Increase in Contribution Rates

2021 Zone Status	2001-2009	2009-2020	2001-2020
Green Zone	+63%	+68%	+175%
Endangered	+73%	+77%	+207%
Critical	+67%	+117%	+261%
Declining	+78%	+126%	+302%
All Plans	+64%	+80%	+196%

Study of Form 5500 data by Segal. Exhibit shows cumulative increases in average contribution rates for active participants. Plans are grouped by 2021 zone status.

Plan Maturity



Study of Form 5500 data by Segal. Graph shows median ratios of non-active participants to active participants at plan year end. Plans are grouped by 2021 zone status.

Observations

- Here, maturity is expressed as ratio of non-active participants to active participants
- Plans in **critical and declining** status in 2021 were more mature than average in 2001 and highly mature now
- Note higher maturity levels in 2020 for non-declining plans, compared with 2001

Significance of Negative Cash Flows

Simplified Two-Year Example

	Plan A: Cash Flow Neutral		Plan B: Cash Flow Negative	
Plan Year	**Year 1**	**Year 2**	**Year 1**	**Year 2**
Investment Return	-5.0%	**+5.3%**	-5.0%	**+17.0%**
Beginning Assets	**1,000**	950	**1,000**	901
Net Cash Flow	0	0	(50)	(50)
Investment Return	(50)	50	(49)	149
Ending Assets	950	**1,000**	901	**1,000**

Post-SFA Plan Design

Updating the Rehabilitation Plan

- Consider updates to reflect receipt of SFA
- New funding objectives
  - Longer solvency horizon
  - SFA phased into funding calculations
  - Deemed critical status through 2051
- Contribution rate increases
  - Future increases disregarded from SFA calculation
  - What future increases are reasonable post-SFA?

Benefit Improvements

- Restrictions apply through 2051
- Reinstatement of suspended benefits is OK
- Retroactive improvements are generally <u>not</u> OK
- Prospective improvements may be OK if paid for with additional contributions
  - General restriction on benefit improvements for plans in red zone still applies (see next slide)

Benefit Improvements

ERISA section 305(f)(1)(B)

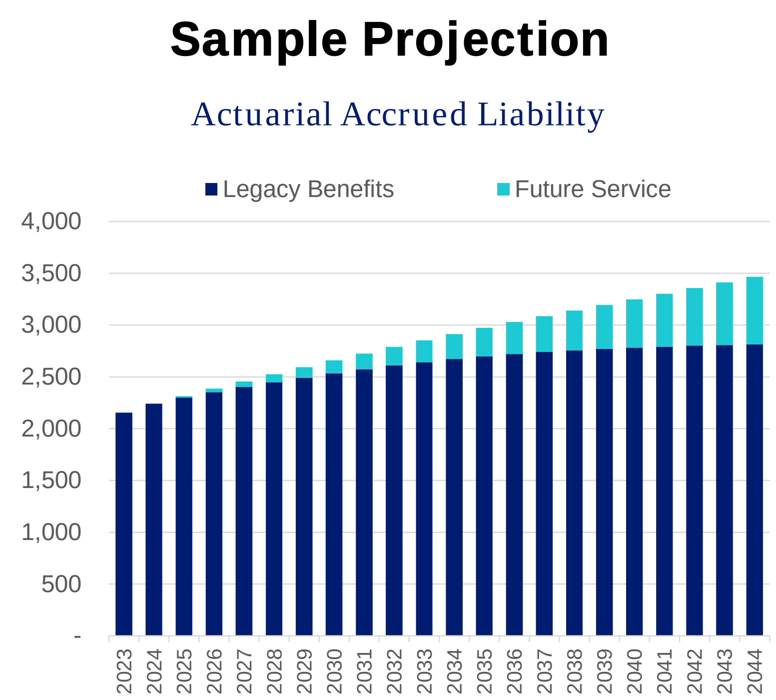
Special rules for benefit increases. A plan may not be amended after the date of the adoption of a rehabilitation plan under subsection (e) so as to increase benefits, including future benefit accruals, unless the plan actuary certifies that such increase is paid for out of additional contributions not contemplated by the rehabilitation plan, and, after taking into account the benefit increase, the multiemployer plan still is reasonably expected to emerge from critical status by the end of the rehabilitation period on the schedule contemplated in the rehabilitation plan.

Variable Annuity Designs

- Variable Annuity Plan (VAP) overview
  - "Hybrid" risk-sharing plan design
  - Benefits automatically adjust with plan asset returns
  - VAP benefits apply to future service only
  - Legacy benefits remain fixed
- Considerations
  - How much will VAP reduce overall plan risk?
  - Will VAP expand contribution base?
  - Restrictions on benefit improvements

Future Service Plan Design

- For most multiemployer plans, going VAP for future service is a **long-term** de-risking strategy.
- For SFA plans, changing the plan design for future service may have minimal impact.



Mergers and Transfers

- General
  - Must comply with general rules under ERISA 4231
  - Must be **approved by PBGC**
- After merger with non-SFA plan:
  - Separate tracking of SFA plan and non-SFA plan
  - 33% rule still applies to SFA assets
  - More flexibility with certain other conditions.

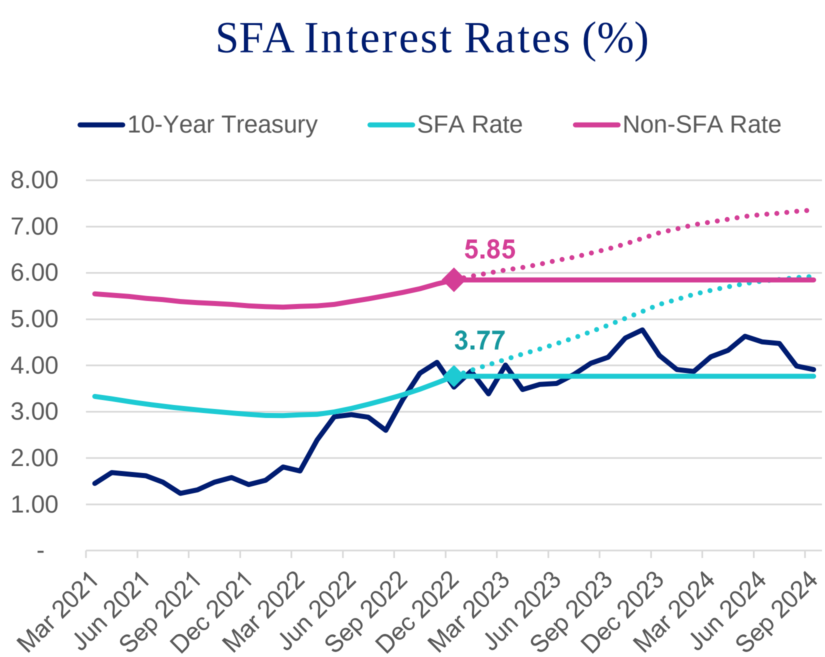
Post-SFA Investment Strategy

Post-SFA Investment Strategy

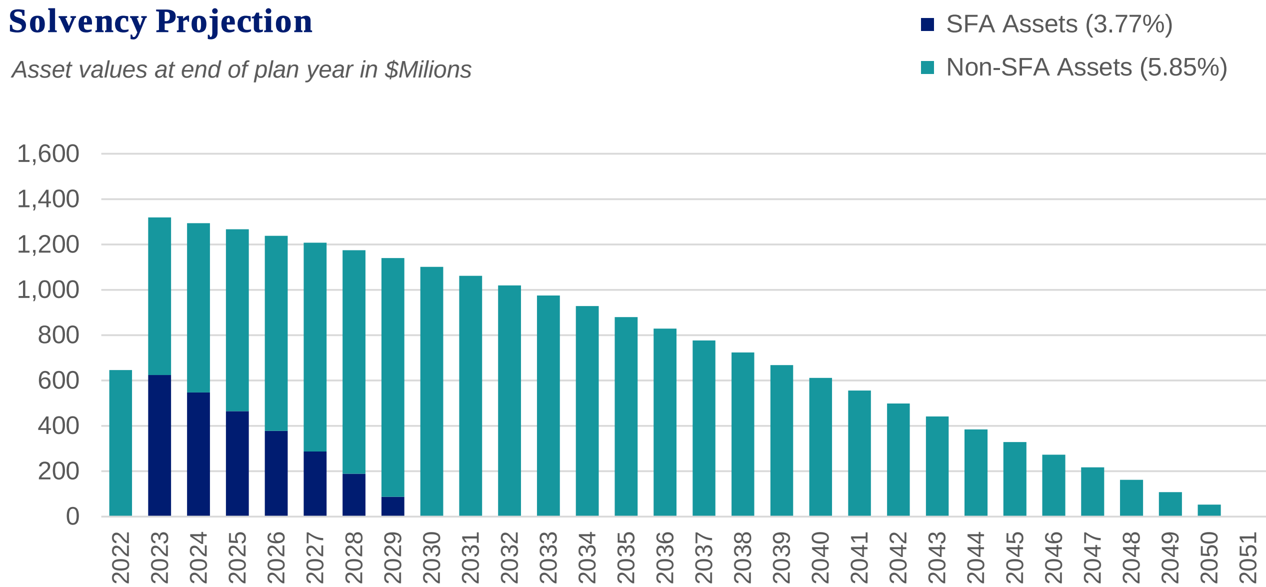
- Define funding target
- Re-evaluate actuarial assumptions
  - May differ from SFA application
  - More "conservative" assumptions could lead to higher allocations to return-seeking assets
- Consider restrictions on benefit improvements
- Consider risk reduction strategies

SFA Interest Rates

- SFA amount based on two interest rates:
  - SFA assets
  - Non-SFA assets
- Both SFA interest rates are 24-month averages
- PBGC allowed plans to **lock in** SFA interest rates at December 31, 2022



SFA Application: 3.77%, 5.85%

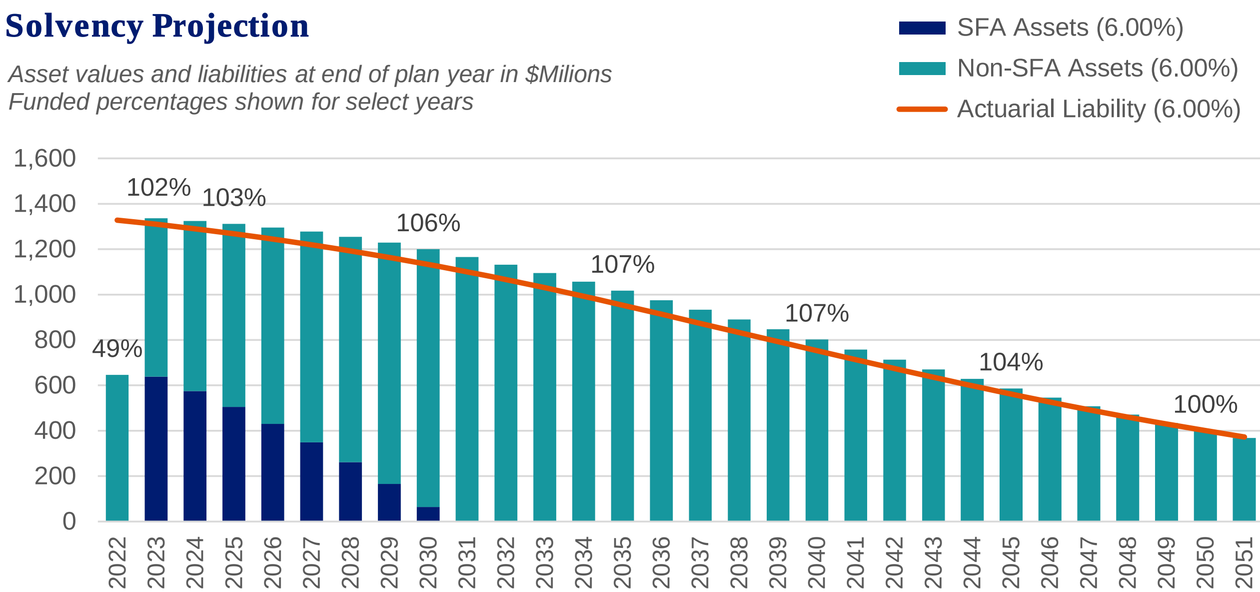


Illustrative projection. Results will vary by plan.

Notes

- SFA of $700 million awarded in 2023
- Investment returns:
- SFA = 3.77%
- Legacy = 5.85%
- Equivalent to single effective return of 5.46%
- Insolvency projected in 2051

Assumed Returns: 6.00%, 6.00%

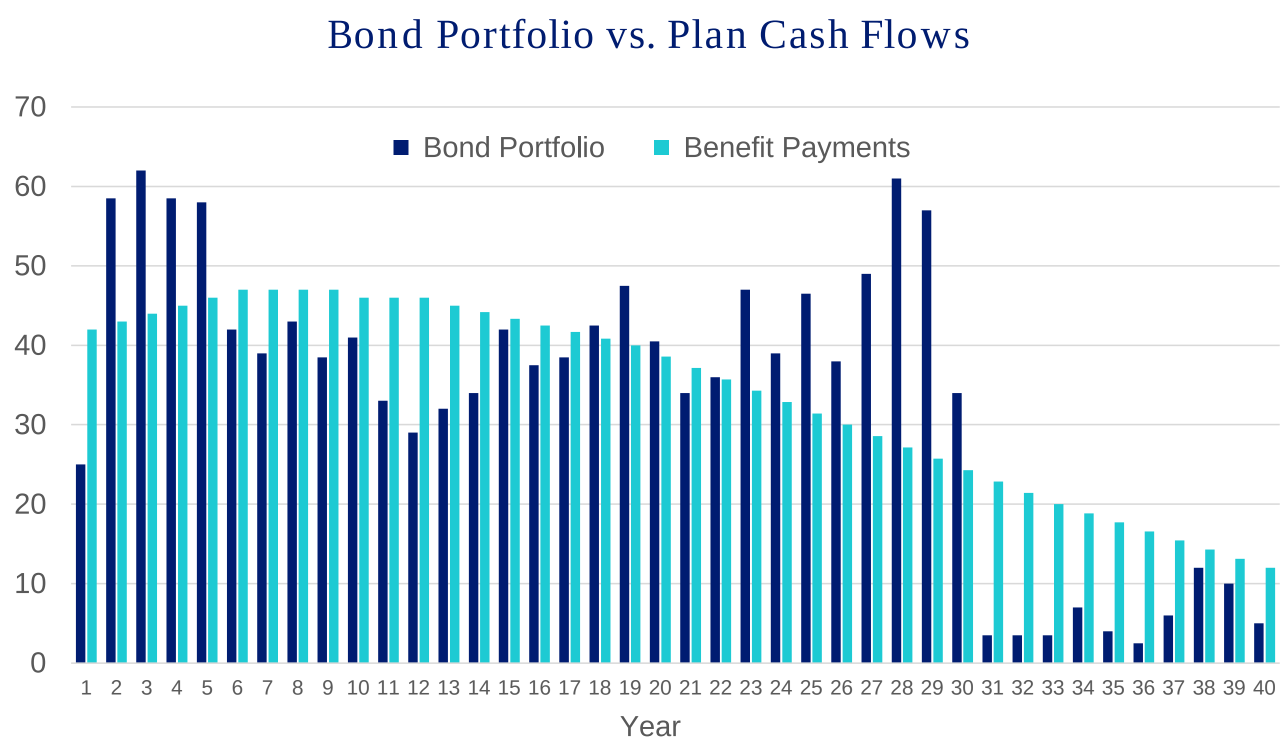


Illustrative projection. Results will vary by plan.

Notes

- SFA of $700 million awarded in 2023
- Investment returns 6.00% per year on total assets (SFA + legacy)
- Actuarial interest assumption is 6.00%
- Projected funding remains around 100%

Benefits-Driven Investing



Notes

- Bond portfolio payments include coupons (interest) and principal
- Benefits-driven investing (BDI) may also be called liability-driven investing (LDI)

Two Immunization Strategies

Short-Term Cash Flow Matching	Long-Term Immunization
Pay near-term benefits and expenses from a **dedicated portfolio** of high-quality fixed income. Avoid “selling low” in a down market to pay plan obligations.	**Match duration** of a portion of benefit liabilities with high-quality fixed income. Eliminates interest rate risk and investment volatility risk for immunized liabilities.

Both strategies can be strategically extended based on funding metrics.

Case Study 1

Background

- Before receiving SFA, Plan was in critical and declining status
- **Priority group 2**
- Received SFA in **2022**
- Interest rates:
  SFA = 2.95%,
  non-SFA = 5.29%

Post-SFA Strategy

- Annual investment return needed to remain solvent indefinitely **< 4.0%**
- SFA assets: **Long-term immunization** with Treasuries
- Legacy assets:
  Mostly return-seeking

Case Study 2

Background

- Before receiving SFA, Plan was in critical and declining status
- **Priority group 6**
- Received SFA in **2023**
- Interest rates:
  SFA = 3.77%,
  non-SFA = 4.50%

Post-SFA Strategy

- Annual investment return needed to remain solvent indefinitely **~ 4.5%**
- **Cash flow matching** strategy covering benefits and expenses for the next 5 years
- Extend cash flow match based on funding levels

Case Study 3

Background

- Before receiving SFA, Plan was in critical and declining status
- **No priority status**
- Received SFA in **2024**
- Interest rates:
  SFA = 3.77%,
  non-SFA = 5.85%

Post-SFA Strategy

- Annual investment return needed to remain solvent indefinitely **~ 6.0%**
- Dynamic **benefit-driven investing (BDI)** strategy
- Allocation to BDI assets based on funding levels

Key Takeaways

- Know the annual investment return needed to remain solvent indefinitely
- Understand whether alternative plan designs will significantly reduce risk
- Evaluate immunization strategies
- Always keep in mind annual statement of compliance

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Session Evaluation

Questions?