2014 a so-so year for most multiemployer plans; impact of new legislation remains to be seen

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Welcome to Milliman's Spring 2015 Multiemployer Pension Funding Study. This study reports on the estimated funded status of all U.S. multiemployer plans as of December 31, 2014, and shows the change in funding levels from December 31, 2013.

KEY FINDINGS

- The aggregate funded percentage for multiemployer plans was estimated to be 80% as of December 31, 2014, compared with 81% as of December 31, 2013.
- For most multiemployer pension plans, the 2014 investment experience is estimated to be slightly less than what was expected by the plans' actuarial assumptions.
- The more mature plans continue to struggle to recover from the financial crisis.
- Over one-half of the total underfunding for multiemployer plans is attributed to the 15% of plans that are less than 65% funded.

CURRENT FUNDED PERCENTAGE

Figure 1 shows that the overall funding shortfall for all plans increased by $5 billion for the year ending December 31, 2014, while the aggregate funded percentage decreased slightly to 80%.

FIGURE 1: FUNDED PERCENTAGE, ALL MULTIEMPLOYER PLANS* (IN $ BILLIONS)

	12/31/2013	12/31/2014	CHANGE
LIABILITY FOR ACCRUED BENEFITS	$585	$597	$12
MARKET VALUE OF ASSETS	473	480	7
SHORTFALL	$112	$117	$5
FUNDED PERCENTAGE	81%	80%	-1%

*Based on plans with complete IRS Form 5500 filings. Includes 1,294 plans as of December 31, 2013, and 1,278 plans as of December 31, 2014.

The key assumption here is the discount rate used to measure liabilities, with each plan using its actuary's assumed return on assets assumption. Assumed returns are generally between 6% and 8%, with a weighted average assumption for all plans of about 7.5%.

HISTORICAL FUNDED PERCENTAGE

Figure 2 provides an historical perspective on the aggregate funded percentage of all multiemployer plans since the end of 2007 on a market value basis. Multiemployer plans were more than 85% funded prior to the 2008 financial crash, recovering from an unfavorable investment environment in the early 2000s and funding rules that did not allow plans to build large surpluses. The graph in Figure 2 shows that these plans were subject to the same market forces in 2008 and early 2009 that affected all retirement plans, including 401(k) plans and other similar savings vehicles as well as the personal savings of millions of Americans. While there has been significant recovery from the low point in 2009, the aggregate funded percentage has not yet returned to pre-2008 levels. However, even with the unprecedented market collapse in 2008, multiemployer plan funding levels have steadily improved, but leveled off in 2014.

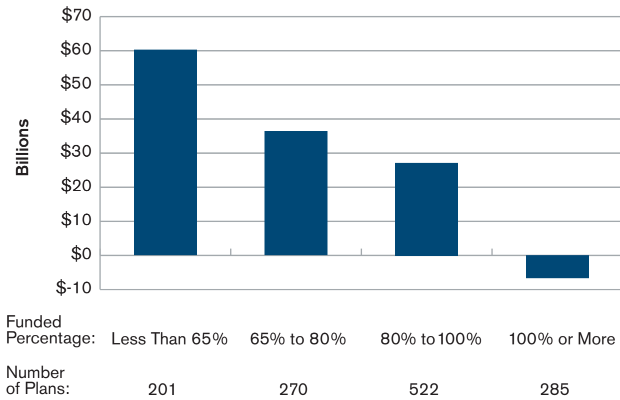
FIGURE 2: AGGREGATE MULTIEMPLOYER PLAN HISTORICAL FUNDED PERCENTAGE – MARKET VALUE BASIS

The significant improvement in aggregate funded status since early 2009 reflects not only favorable investment returns but also contribution increases (including withdrawal liability collections) and benefit reductions enacted by plans as they responded to the financial crisis. One common misconception is that plans should be back on their feet because the stock market has surpassed its levels from before the financial crisis. However, liabilities have been growing at 7.5% per year on average, so market prices would need to be significantly higher today than they were prior to the financial crisis to have kept pace with liability growth.

RESULTS VARY BY PLAN

While aggregate funding levels of multiemployer plans have nearly returned to pre-crash levels, the financial crisis has affected individual plans in different ways. Figure 3 looks at the funded percentage distribution of individual plans.

FIGURE 3: DISTRIBUTION OF PLANS BY FUNDED PERCENTAGE AND SHORTFALL– MARKET VALUE BASIS



In Figure 3, we see that 285 multiemployer plans are over 100% funded as of December 31, 2014, with an aggregate surplus of about $6 billion. The $60 billion shortfall for the 201 multiemployer plans that are less than 65% funded, about 15% of all plans, accounts for more than half of the aggregate deficit for all multiemployer plans of $117 billion.

FIGURE 4: APPROXIMATE ANNUAL CASH FLOW, ALL PLANS IN AGGREGATE (IN $ BILLIONS)

CONTRIBUTIONS	$24
BENEFIT PAYMENTS	-38
EXPENSES	-3
NET CASH FLOW	-$17
NET CASH FLOW AS % OF ASSETS	**-3.9%**

One of the primary reasons more mature plans struggle to recover from poor experience is that benefit payments and plan expenses increasingly outweigh contributions. This “negative cash flow” is expected in the life of all pension plans and is precisely why ERISA required that pension plans be pre-funded, but it does make it more difficult for plans to recover from unfavorable experience. Figure 4 shows that, in the aggregate for all multiemployer plans, benefit payments plus expenses are well in excess of contributions.

FIGURE 5: MOST RECENT ZONE STATUS BY CASH FLOW

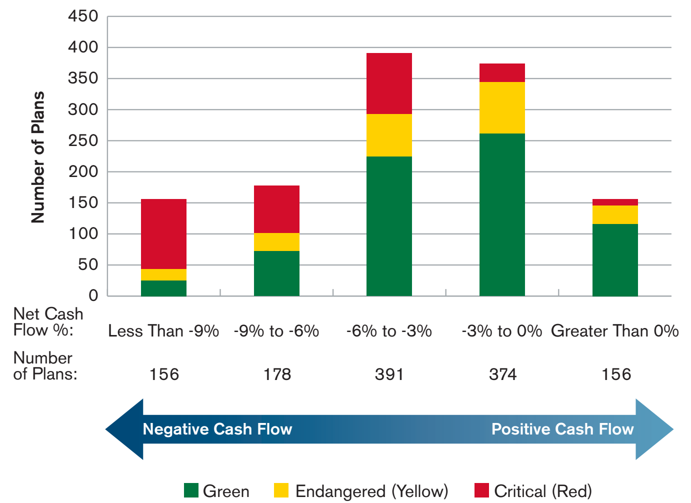


Figure 5 shows that plans with positive or slightly negative cash flows are more likely to be in the green zone than plans with more negative cash flows. For this purpose, cash flows are defined to be contributions less benefit payments and expenses, as a percentage of the market value of assets.

Only 7% of multiemployer plans with positive cash flow are in critical status, while 72% of multiemployer plans with a negative 9% or more cash flow are in critical status. While cash flow tends to correlate with zone status, we do see plans with positive cash flow that are not in the green zone and plans with negative cash flow that are in the green zone. Large negative cash flows magnify the impact of investment volatility and make it harder for plans to recover from an underfunded status, as they are forced to liquidate assets to meet obligations before asset values can recover. For all plans in general, and underfunded plans in particular, this situation puts more pressure on investment performance because the net cash outflows deplete the assets available to experience good investment returns.

RETURNS NEEDED TO REACH 100% FUNDING

For plans in need of financial recovery, the biggest driver is investment performance. To quantify the level of asset performance that plans will need, we have calculated an illustrative “recovery return” for each plan, which approximates the constant rate of return needed over the next 10 years for a plan to reach 100% funding.

FIGURE 6: DISTRIBUTION OF PLAN RECOVERY RETURNS

% OF PLANS WITH RECOVERY RETURN OF	12/31/2012	12/31/2013	12/31/2014
6% OR LESS	14%	25%	25%
6%-8%	17%	24%	22%
8%-10%	25%	23%	24%
10% OR MORE	44%	28%	28%
RECOVERY RETURN, ALL PLANS IN AGGREGATE	10.30%	8.75%	9.05%

Figure 6 shows more than half of all plans would still need to earn 8% or more over the next 10 years to reach 100% funding within that timeframe, assuming no changes to current cash flows. For all plans in aggregate, returns of 9.05% per year are needed over the next 10 years to reach 100% funding. Importantly, even if a plan recovers to 100% funding, the assumed return (7.5% on average) is still needed to stay fully funded. The needed aggregate rate increased from 8.75% to 9.05% because plans in aggregate are slightly less well funded this year.

MPRA 2014

On December 16, 2014, President Obama signed a new law that includes the Multiemployer Pension Reform Act of 2014 (MPRA). Among other provisions, the new law permanently extends the multiemployer provisions of the Pension Protection Act of 2006 that were set to expire at the end of 2014. In addition, MPRA increases the Pension Benefit Guaranty Corporation (PBGC) premiums that multiemployer plans will pay to the PBGC from $13 to $26 per participant for 2015.

MPRA also defines a new status for multiemployer plans called "Critical and Declining." A multiemployer plan is in Critical and Declining Status if it is projected to be insolvent within 15 years, or 20 years if there are at least twice as many inactive as active participants or the plan's funded percentage is less than 80%. Trustees of Critical and Declining Status plans may, under certain circumstances, suspend or reduce benefits down to 110% of the monthly benefit guaranteed by the PBGC. It remains to be seen how the new law will impact the funded percentage of the most severely underfunded plans.

Please review our *Multiemployer Reviews* for further information on this new legislation.

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ABOUT THE MILLIMAN MULTIEMPLOYER PENSION FUNDING STUDY

The results in this study were derived from publicly available Form 5500 data as of December 2014 for all multiemployer plans, numbering between 1,200 and 1,300, depending on the measurement date used. Data for a limited number of plans that clearly appeared to be erroneous was modified to ensure the results were reasonable and a sufficiently complete representation of the multiemployer universe.

Liability amounts were based on unit credit accrued liabilities reported on Schedule MB, and were adjusted to the relevant measurement dates using standard actuarial approximation techniques. For this purpose each plan's monthly cash flow, benefit cost, and actuarial assumptions were assumed to be constant throughout the year. Projections of asset values reflect the use of constant cash flows and monthly index returns for a simplified portfolio comprised of 45% U.S. equities, 20% international equities and 35% U.S. fixed-income investments.

Significant changes to the data and assumptions could lead to much different results for individual plans but would likely not have a significant impact on the aggregate results or the conclusions in this study.