Segal Consulting

Survey

Benefits, Compensation and HR Consulting SPRING 2014

Survey of Calendar-Year Plans' 2014 Zone Status

In 2014, a solid majority of calendar-year multiemployer pension plans — 65 percent — are in the green zone,[1] according to Segal Consulting's *Survey of Calendar-Year Plans' 2014 Zone Status*. That percentage represents an increase of 4 percentage points from 2013 (61 percent). It is significantly higher than it was in 2010 (54 percent) and dramatically higher than in 2009 (39 percent).

The average Pension Protection Act of 2006 (PPA'06) funded percentage[2] for the surveyed plans is 88 percent in 2014, up 3 percentage points from 2013.

"In 2014, a solid majority of calendar-year multiemployer pension plans…are in the green zone. …[and the] average Pension Protection Act of 2006 (PPA'06) funded percentage for the surveyed plans is 88 percent."

One reason for the improvement is the ongoing strengthening of the investment markets. For 2013, the return for multiemployer pension funds with a typical (40 to 70) percent allocation to equities ranged from 11.5 to 21.4 percent, according to Segal Rogerscasey (the SEC-registered investment solutions member of The Segal Group).[3] Further, trustees have taken steps to strengthen their plans as permitted by PPA'06.

Another significant finding is that 91 percent of the red- or yellow-zone calendar-year plans that are now in their rehabilitation or improvement period reported meeting "scheduled progress" as defined in their Rehabilitation Plan (RP) or Funding Improvement Plan (FIP).[4]

The Flip Side

Unfortunately, in spite of the general improvement of the funded status of multiemployer plans, there are still some plans, covering hundreds of thousands of participants, which will eventually become insolvent.

Zone Status

Details about the change in calendar-year plans' zone status follow:

- ***For 2014, 65 percent of calendar-year plans are in the green zone.*** As noted at the beginning of this report, this represents an increase from 2013. However, it is still short of 83 percent, the percentage of plans in the green zone at the January 1, 2008 inception of the PPA'06 zone rules, prior to the 2008 market downturn.

"Another significant finding is that 91 percent of the red- or yellow-zone calendar-year plans that are now in their rehabilitation or improvement period reported meeting 'scheduled progress.'"

- ***For 2014, fewer calendar-year plans are in the yellow zone: 8 percent, down from 11 percent.*** This is less than the 2008 survey, when 10 percent were in the yellow zone.
- ***The percentage of calendar-year plans in the red zone fell by 1 percentage point between 2013 and 2014.*** For 2014, 27 percent of calendar-year plans are in the red zone, down from 28 percent in 2013. This is in sharp contrast to 2008, when only 7 percent of the surveyed plans were in the red zone.

About the Survey

The survey data is based on actual certifications for almost 220 calendar-year multiemployer plans (all of which are Segal clients) that represent a wide range of industries from across the country with combined assets of almost $100 billion. The certifications took into account changes in plan design, employment outlook, negotiated contribution rates and investment performance through the end of 2013.

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[1] The text box on the last page provides background on the zones.

[2] The PPA'06 funded percentage is based on a ratio of assets to accrued benefits, measured using the plan actuary's actuarial assumptions and the plan's actuarial asset valuation method.

[3] This information is from Segal Rogerscasey's performance measurement platform.

[4] For more information about FIPs and RPs, see Segal's August 2006 *Bulletin*, "Pension Protection Act of 2006's Key Multiemployer Plan Provisions": http://www.segalco.com/publications/bulletins/aug06PPAmulti.pdf

"Plans that fell into the red zone as a result of the market downturn in 2008 have largely stayed there, whereas many plans that fell into the yellow zone have generally moved into the green zone."

Since last year's survey of calendar-year plans, just under 4 percent (eight plans) emerged from the yellow zone or red zone into the green zone. Just under 1 percent (two plans) changed status from green to red or yellow, and just under 1 percent (two plans) changed status from yellow to red.

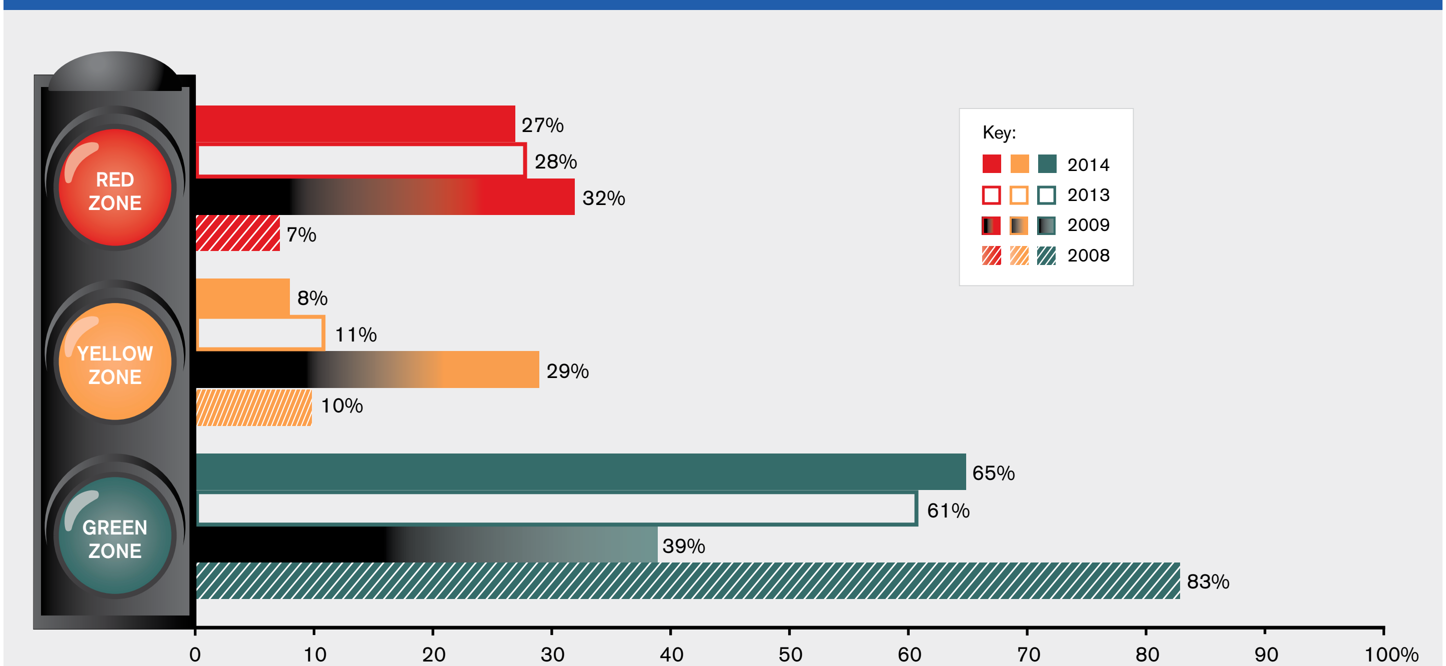
Graph 1 shows how the zone-status breakdown of calendar-year plans changed from 2008 to 2014. It appears that plans that fell into the red zone as a result of the market downturn in 2008 have largely stayed there, whereas many plans that fell into the yellow zone have generally moved into the green zone.

The survey results show a few industry differences in the calendar-year plans' zone status. Notably, for 2014, the construction and service industries have the greatest percentage of plans in the green zone (73 percent), with the manufacturing and entertainment industries not far behind (63 percent). The service industry experienced the greatest improvement in the percentage of green-zone plans from 2013 to 2014: 14 percentage points. The retail trade and food industry has the greatest percentage of red-zone plans for 2014 (56 percent) with transportation close behind (54 percent). See Graph 2 on the next page.

As shown in Graph 3 on the next page, in general, asset size is not a factor in zone status. The majority of plans in most asset-size groups were in the green zone.

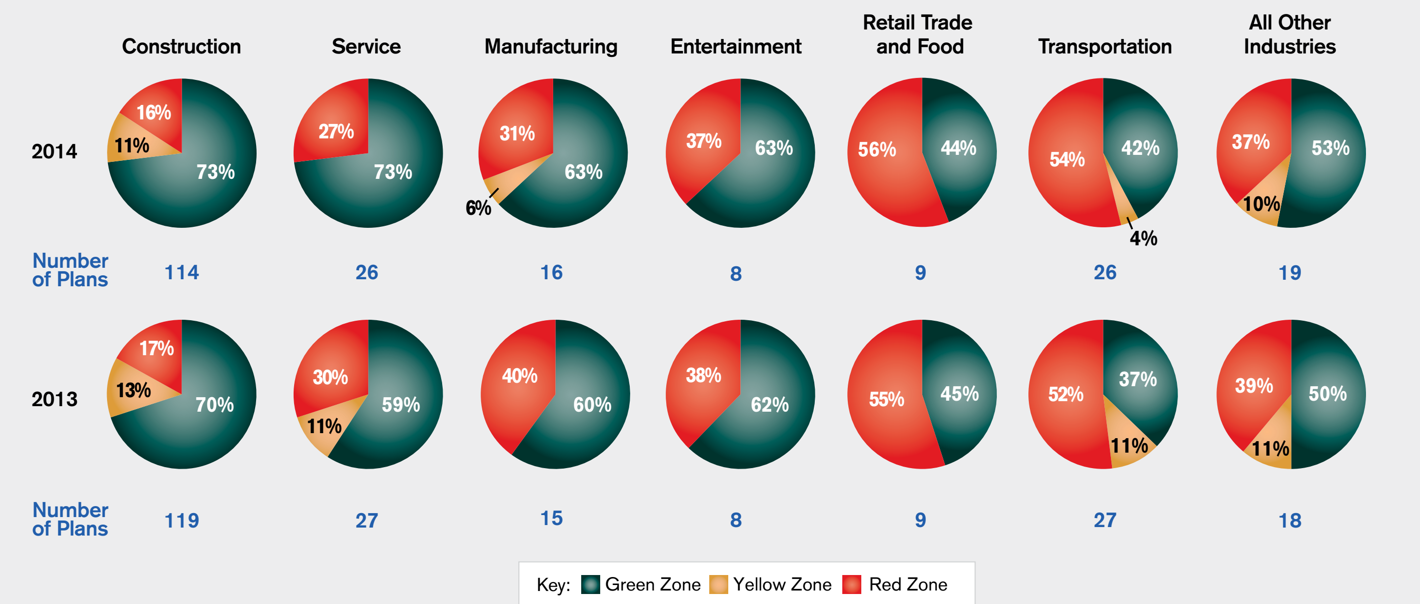
"Notably, for 2014, the construction and service industries have the greatest percentage of plans in the green zone."

Graph 1: Breakdown of Calendar-Year Plans' 2014, 2013, 2009 and 2008 Zone Status by Percentage of Plans in Each Zone*



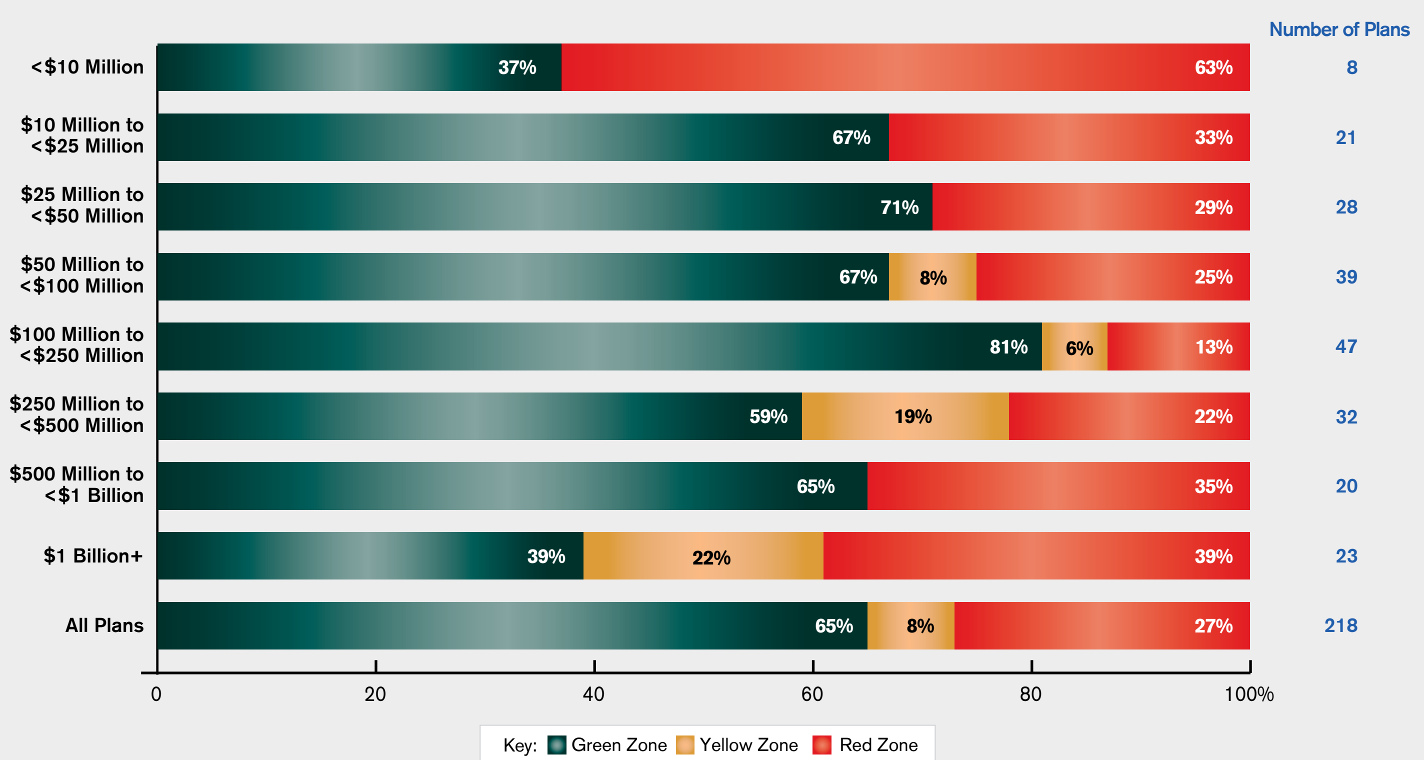
* This graph shows data from the two most recent surveys and from 2009 (reflecting the 2008 investment performance, the first year of the market downturn) and 2008 (reflecting 2007 investment performance). For each year, the zone-status breakdown is based on calendar-year plans' certifications, which were due by the end of March and reflect investment performance through the end of the prior year. For example, the 2014 survey data is based on certifications that were due by the end of March 2014, reflecting investment performance through December 31, 2013. Reports of results from all of Segal's zone-status surveys can be accessed from the following page of Segal's website: http://www.segalco.com/publications-and-resources/multiemployer-publications/surveys-studies/ An online supplement to this survey report, which includes a table showing the zone-status breakdown of plans for each year from 2008 to 2014, is available on the following page of Segal's website: http://www.segalco.com/publications/surveysandstudies/spring2014zonesupp1.pdf

Graph 2: Industry Breakdown of Calendar-Year Plans' 2014 and 2013 Zone Status by Percentage of Plans in Each Zone

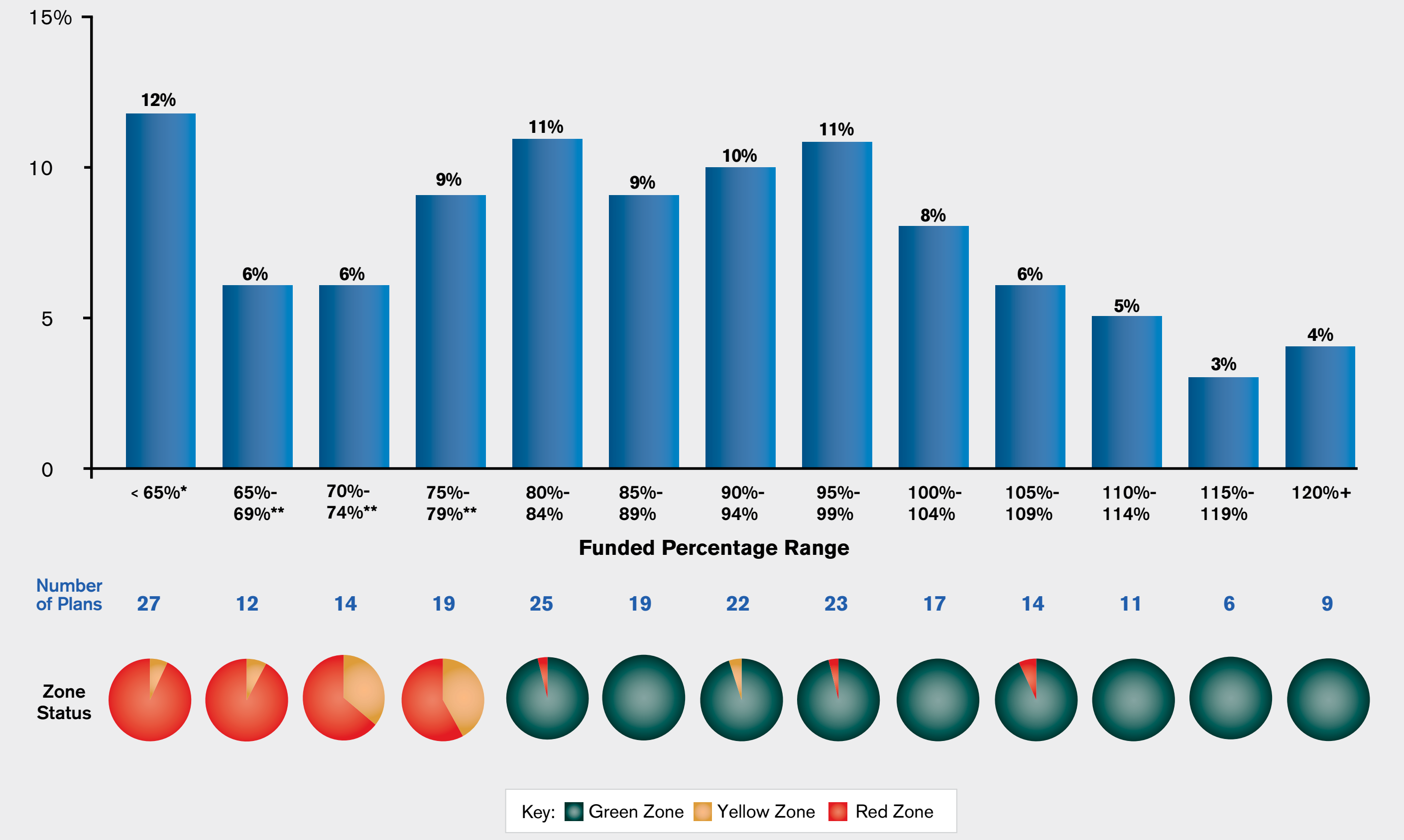


Note: An online supplement to this survey report, which features a graph showing the zone-status breakdown of plans by number of participants, is available on the following page of Segal's website: http://www.segalco.com/publications/surveysandstudies/spring2014zonesupp1.pdf

Graph 3: Breakdown of Calendar-Year Plans' 2014 Zone Status by Plan Assets



Graph 4: Percentage, Number and 2014 Zone Status of Calendar-Year Plans by PPA'06 Funded Percentage Range



* This funded percentage threshold is one of several criteria for determining red-zone status.

** A funded percentage less than 80 percent is one of the primary criteria for determining yellow-zone status.

PPA'06 Funded Percentage

The average PPA'06 funded percentage for the plans in the survey is 88 percent, up from 85 percent in 2013. The average PPA'06 funded percentage for 2014 is still lower than the average for the 2008 survey (97 percent). The PPA'06 funded percentage is based on the "actuarial asset value" for each plan, which does not reflect all of the market gains and losses each year.

Twenty-six percent of the plans in the survey have a PPA'06 funded percentage of 100 percent or more. (In 2013, about 22 percent of the plans in the survey had a PPA'06 funded percentage of 100 percent or more.) The bars in Graph 4, above, show a breakdown of plans in the survey by their 2014 PPA'06 funded percentage. The small pie charts indicate the zone status for the plans in each funded percentage range.

"Twenty-six percent of the plans in the survey have a PPA'06 funded percentage of 100 percent or more."

Together, both sets of data illustrate that there is not always a direct correlation between the PPA'06 funded percentage and zone status. It is important to remember that no single measurement is sufficient for an actuary to determine a plan's zone status under PPA'06.

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Commentary and Outlook

> "A plan's zone status for the plan year beginning on or after January 2014…may have even greater implications than in prior years, given uncertainty surrounding the scheduled 'sunset' of selected PPA'06 zone provisions at the end of 2014."

The results of Segal's *Survey of Calendar-Year Plans' 2014 Zone Status* reveal that a solid and growing majority of multiemployer pension plans are in the green zone. The average PPA'06 funded percentage has also increased.

A plan's zone status for the plan year beginning on or after January 2014 (for calendar-year plans, the zone certification due by the end of March 2014) may have even greater implications than in prior years, given uncertainty surrounding the scheduled "sunset" of selected PPA'06 zone provisions at the end of 2014.[5]

While the increase in the percentage of green-zone plans is good news, the survey shows that some multiemployer plans are still facing funding challenges. Many plans are still recognizing earlier investment losses triggered by the 2008/early 2009 market downturn and/or are in industries in which employment is still far below pre-recession levels.[6] Importantly, there are financially troubled plans, including some very large plans, that are facing longer-term insolvency unless critically needed legislative solutions are enacted.

Trustees of some yellow-zone and red-zone plans have had to implement actions to improve their funding status, such as benefit changes, higher contribution rates and changes to investment policies. If they have not already done so, trustees of the small percentage of green-zone plans that are expected to migrate to the yellow or red zones over the next five years may wish to consider similar actions. Trustees of some green-zone plans have improved benefits given the return to pre-recession employment in their industries and the continued strong status of their plans in spite of the volatility of the market. These improvements may result in an immediate decrease in their funded percentage.

The results of the *Survey of Calendar-Year Plans' 2014 Zone Status* highlight how important it is for trustees to understand their plan's vulnerability to risks, such as investment risk (*i.e.*, the volatility of returns), employment risk (*i.e.*, an employment level that falls

[5] For information about the sunset, see the text box below.

[6] Some plans that elected funding relief in 2010 under the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (PRA 2010) extended the impact of 2008–2009 investment losses in the actuarial value of assets during the following 10 years. For more information on this relief provision of PRA 2010, see Segal's July 2010 *Bulletin*, "Temporary Pension Funding Relief or Multiemployer Plans": http://www.segalco.com/publications/bulletins/july2010relief.pdf

On the Horizon: "Sunset" of the PPA'06 Zone-Certification Rules

The *zone-certification* rules of PPA'06 will expire ("sunset") for plan years beginning after December 31, 2014, unless Congress acts to extend or eliminate the deadline. (Other PPA'06 provisions, such as the requirement to prepare an Annual Funding Notice, will *not* be affected by this sunset.)

While green zone plans will continue to operate under the funding rules for financially healthy plans put into place by PPA'06, a continuation clause in the law will extend the expiring provisions of the law for plans that are in the yellow or red zone and that are operating under a Funding Improvement Plan (FIP) or Rehabilitation Plan (RP) in the plan year beginning in 2014.* The impact of the sunset on these plans is unclear.**

In light of uncertainty about the application of the continuation clause, trustees of plans that are entering into or are already in the yellow or red zone this year will want to make sure that they are comfortable that the measures contained in their FIPs and RPs are their best course of action, before the commencement of the 2015 plan year.

* All provisions of the Internal Revenue Code and the Employee Retirement Income Security Act relating to the operation of the FIP or RP also will remain in effect during that period.

** For more information about the sunset, refer to the following Segal Consulting resources:

- February 6, 2014 *Compliance Alert*, "PPA'06 'Sunset': Just the Facts," which includes a text box that describes common misconceptions about the PPA'06 sunset (http://www.segalco.com/publications-and-resources/multiemployer-publications/compliance-alert/archives/?id=2497),
- A supplement to the above publication that describes the PPA'06 provisions that are scheduled to sunset (http://www.segalco.com/publications/presentations/PPA06sunset.pdf), and
- February 11, 2014 webinar, "PPA Sunset: How Will It Affect Your Plan?" (http://www.segalco.com/publications-and-resources/archived-presentations-webinars/?id=1023).

"Zone status is only one measure of a plan's funding status as of one point in time. Knowing the 'direction' a plan is headed is very important."

short of expectations) and longevity risk (*i.e.*, increased life expectancy), so that appropriate preemptive or corrective actions can be considered. Continued market volatility, as evidenced in early 2014, underscores the need for ongoing vigilance.

It should be noted that zone status is only one measure of a plan's funding status as of one point in time. Knowing the "direction" a plan is headed is very important. In addition to looking at zone status, trustees should review projections of the plan's long-term funding status.

To assess a plan's vulnerability to risks, it can be helpful for trustees to consult their advisors for answers to questions like the following:

- For plans in the green zone, to what degree can investment strategies mitigate the near-term probability of falling out of that zone without materially harming the longer-term financial health of the plan?
- For yellow-zone or red-zone plans, how much of an effect will changes in investment strategies, or contribution rate increases, make?

For trustees who need to continue to consider actions to improve the funding status of their plans, options might include plan design changes, recommended changes in contribution rates to the bargaining parties and changes to the investment policy.

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Consultants and actuaries from Segal Consulting, together with investment consultants from Segal Rogerscasey, can be of assistance in developing the appropriate strategies for maintaining and enhancing benefit security. Segal has developed Forecast, a dynamic asset-liability modeling tool that allows trustees to analyze future scenarios.

For additional information, contact your Segal consultant or one of the following experts:

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The Zones

Under the current provisions of PPA'06, trustees must review projections of the financial status of multiemployer plans at least annually in order to identify emerging funding challenges so they can be addressed effectively. The plan's actuary must prepare a certification no later than 90 days after the beginning of the plan year. For example, if the plan year began on January 1, 2014, the certification was required by March 31, 2014.

If the actuary's projections reveal an emerging funding problem, a plan will be classified as being in either "endangered status" (nicknamed the yellow zone) or "critical status" (nicknamed the red zone). In either case, the trustees and bargaining parties generally will be required to take specific actions to improve the plan's financial status.*

Plans with a certified funding status that is neither endangered nor critical are considered to be in the "green zone." Although PPA'06 does not require that these plans take any particular action, trustees of green-zone plans need to continue to pay attention to all of the funding indicators that were important prior to PPA'06, in addition to the new PPA'06 measurements, in order to monitor and manage their plans' financial condition effectively.

As discussed in the text box on page 5, the "zone" certification rules created by PPA'06 are scheduled to expire ("sunset") soon.

* The criteria for an emerging funding problem are summarized in an online supplement to this survey report, which is available on the following web page: http://www.segalco.com/publications/surveysandstudies/spring2014zonesupp2.pdf