Multiemployer Pension Plan Funding Status Improved in 2019

Too Early to Know COVID-19 Effect

According to Segal's latest survey of multiemployer pension plans:

The average funded percentage improved in 2019.

The percentage of plans in the green zone increased.

Significantly, these results are based on actuarial certifications determined as of one date: January 1, 2020, the beginning of the plan year.[1] That means they do not reflect the impact of the COVID-19 crisis on financial markets and employment levels that we have seen so far in 2020.

In dealing with the impact of the current crisis, asset smoothing can be useful. By allowing plans to recognize the effects of any single year over multiple years,[2] asset smoothing provides more time to recover. However, plans that are not projected to improve funding over time will need more than just smoothing to get back on track. They need funding relief.

As we get a handle on the short- and long-term impacts of COVID-19 on plan funding levels, it's important to keep in mind that funding for calendar-year plans was at a relative high point as of January 1, 2020. Segal is carefully monitoring trends that reflect the impact of the COVID-19 crisis, as they emerge. For a more detailed discussion of the outlook for multiemployer plans, refer to our recent article, "Will Your Multiemployer Pension Plan Ride Out the Storm?"

[1] The latest survey includes nearly 200 calendar-year plans (those with plan years that start on January 1). As a group, they have nearly $115 billion in assets and provide benefits to more than 2.3 million participants.

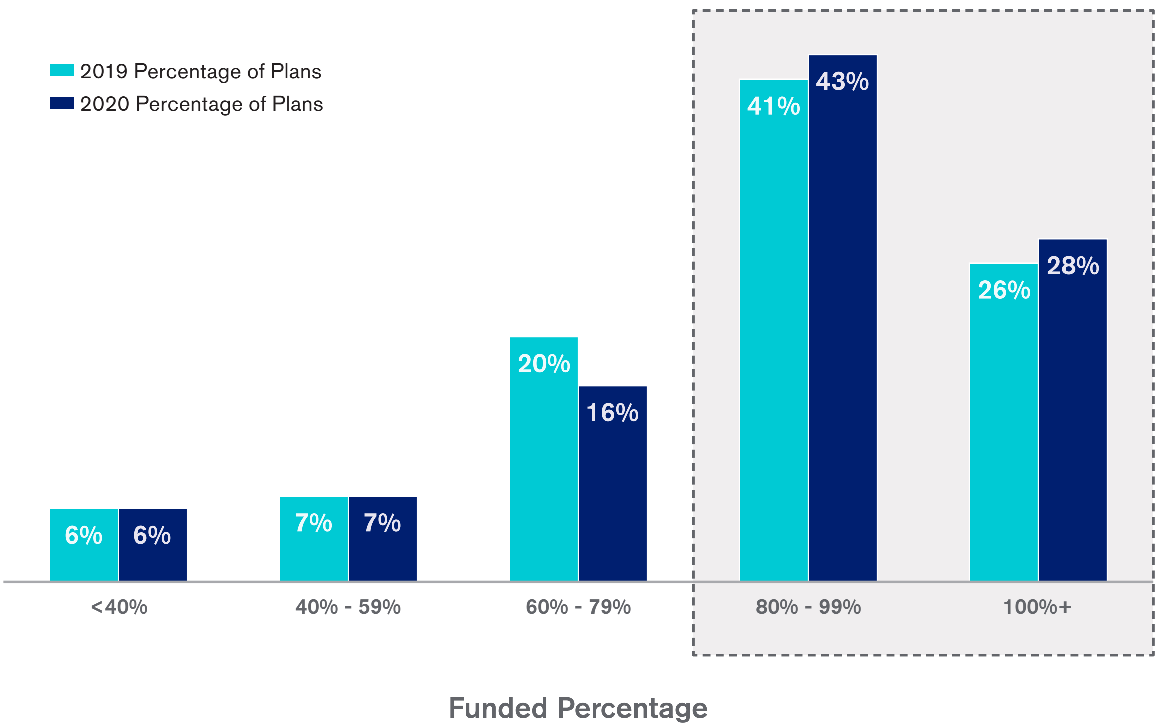
[2] Smoothing typically occurs over five years, but the maximum period has been extended in the past via legislative relief in response to economic downturns.

Improvements in funded percentages as of December 31, 2019

More than 70 percent of plans now have a Pension Protection Act of 2006 (PPA'06) funded percentage[3] of at least 80 percent or more, which is similar to the 2019 results, as shown in the graph below.

Although a number of factors will affect the funded percentage, investment returns are a primary driver. Investment returns that are lower than expected will have an adverse effect on funded percentage while better than expected investment returns will improve the funded percentage. In 2019, the average market-value rate of return (net of investment expenses), was 17.0 percent.

Increase in the Percentage of Plans that Are at Least 80 Percent Funded



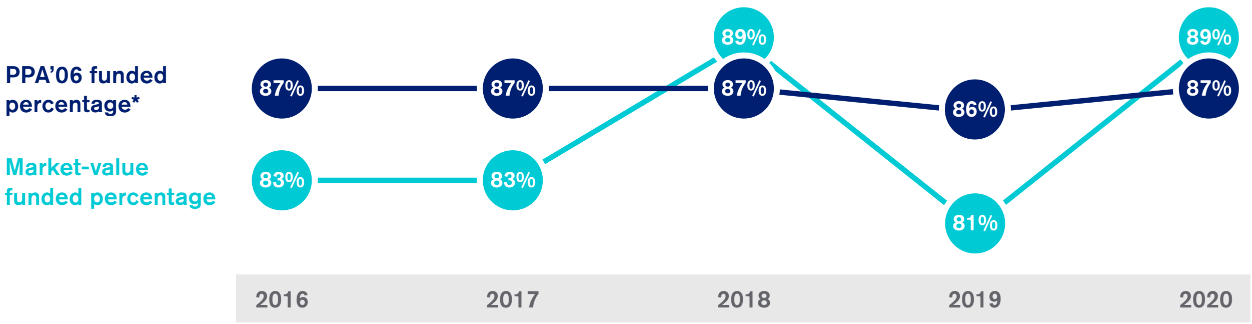
Source: Segal, 2020

[3] The PPA'06 funded percentage is based on a ratio of the *actuarial value* of assets to accrued benefits, measured using the plan actuary's assumptions. A funded percentage of at least 80 percent is one of the requirements to be in the green zone.

The impact of asset smoothing as of December 31, 2019

The graph below shows how the average PPA'06 funded percentage for calendar-year plans changed over the most recent five years as well as a comparable measure using the market value of assets. As of January 1, 2020, the average funded percentage based on the market value of assets was slightly higher than based on the actuarial value of assets.

Effectiveness of Asset Smoothing on the Funded Percentage of All Calendar-Year Multiemployer Plans



* The PPA'06 funded percentage uses the actuarial value of assets.

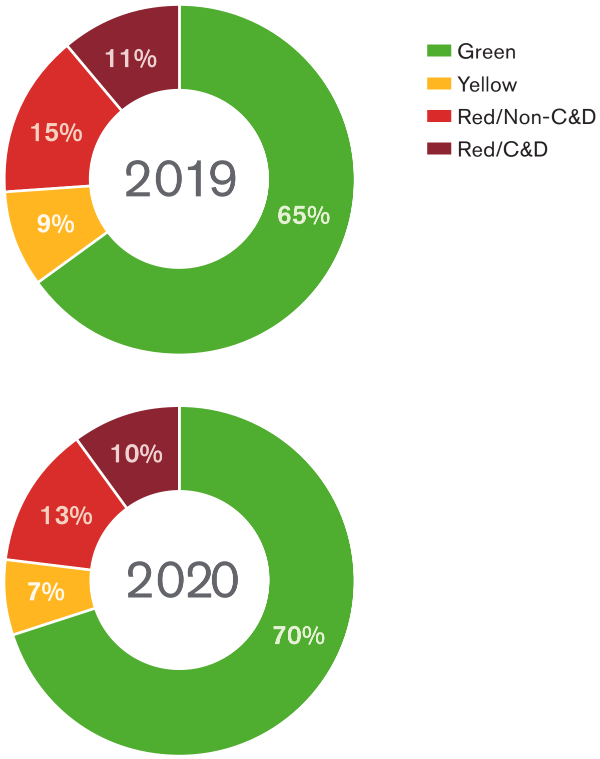
Source: Segal, 2020

The zone status of calendar-year plans improved over 2019

The zone-status breakdown for plans in the survey shows marked significant improvement since the prior year, as illustrated below, particularly for plans in the green zone.[4]

Six plans moved from the red (critical status) zone into the yellow (endangered status) or green zones and six yellow-zone plans became green. Only one plan moved into a lower zone (from green to red). No plans moved into C&D (critical and declining status).

Over Only One Year, a 5-Percentage Point Increase in Green-Zone Plans



Source: Segal, 2020

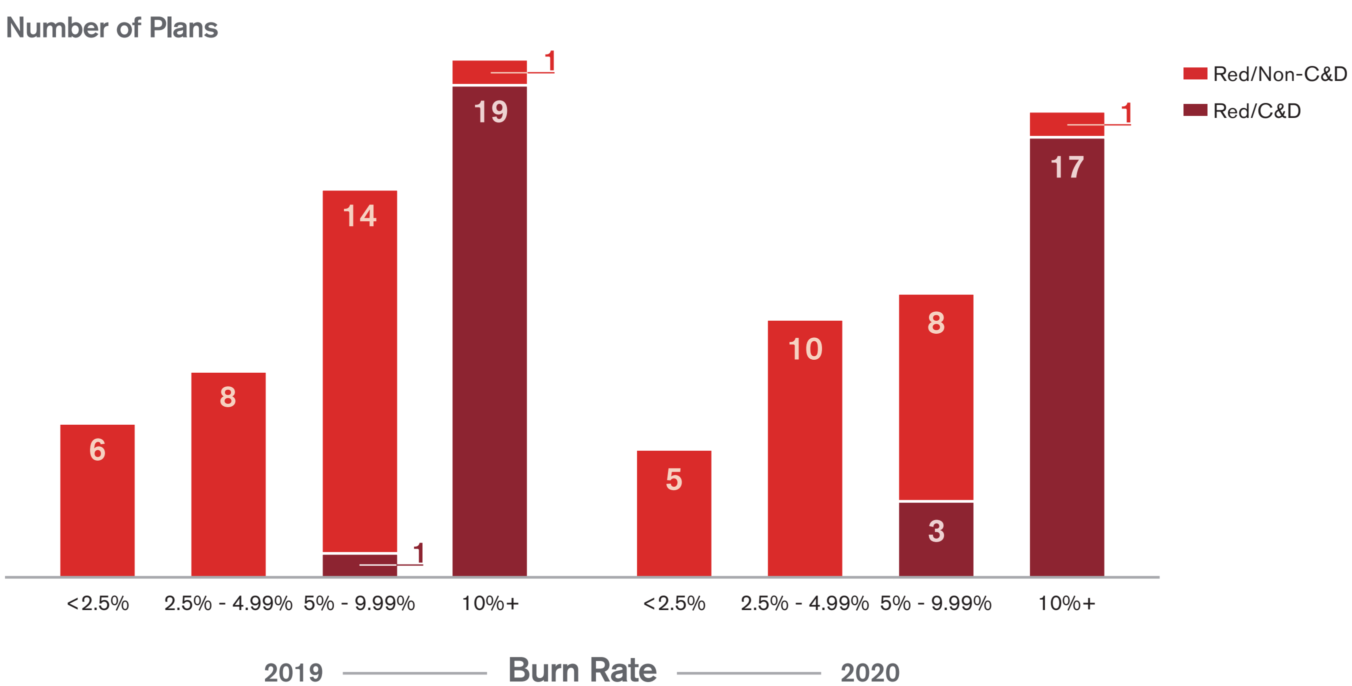
[4] A plan is in the green zone if its funded percentage is at least 80 percent and there is no projected funding standard account deficiency within the next seven years.

Increase in the "burn rate" of plans in the red zone

The burn rate is the rate of asset decline as a percent of total assets, without regard to investment income. A plan's burn rate is significant because it is a key indicator of its ability to pay benefits in the future.

Burn Rate =
(Benefits + Expenses - Contributions) ÷ Assets

The burn rate for C&D plans is much higher than for non-C&D red-zone plans



Source: Segal, 2020

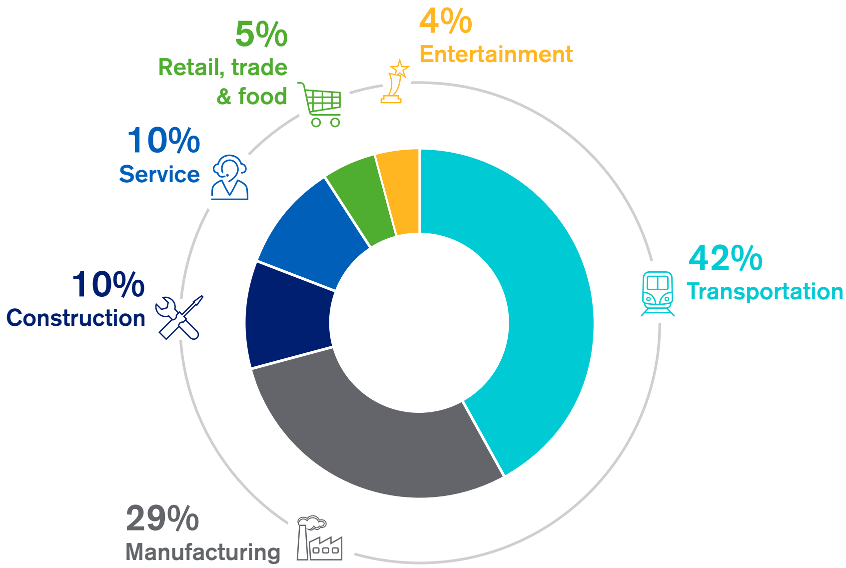
Plans certified as C&D are headed towards insolvency — absent new multiemployer legislation providing additional tools and/or remedies beyond those that are currently available. The burn rate highlights their precarious financial state and underscores their urgent and growing need for more options; otherwise, upon insolvency, the plan becomes completely reliant on the Pension Benefit Guaranty Corporation for payment of benefits, after reductions required under current law.

If investment returns continue to suffer in 2020, we expect there will be more C&D plans with higher burn rates in the near future.

Funding levels as of December 31, 2019 differ by industry

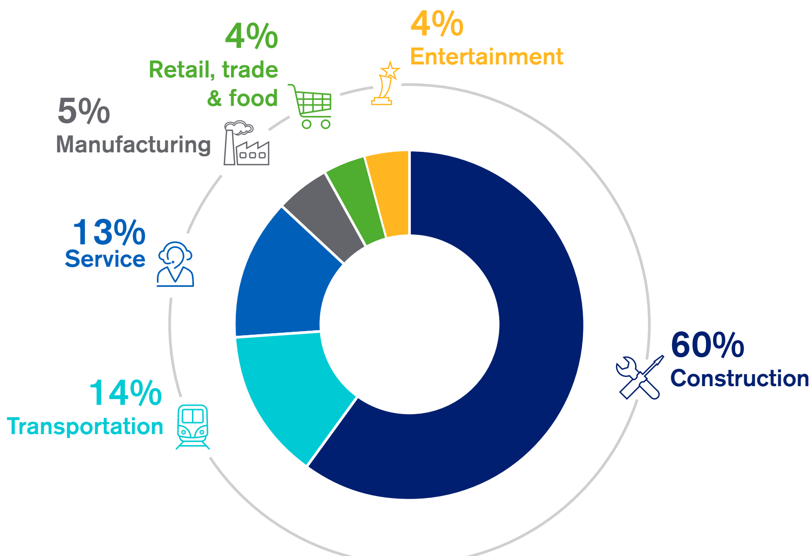
C&D plans are concentrated in two industries. More than half of green-zone plans are in one industry.

Most C&D Plans Are in the Transportation and Manufacturing Industries



Source: Segal, 2020

Majority of Green-Zone Plans Are in the Construction Industry



Source: Segal, 2020

Looking ahead in uncertain times

Of the calendar-year plans that were certified as “green” or “yellow” as of January 1, 2020, one green-zone plan and one yellow-zone plan were projected to be “red” within the next five years, and are eligible to elect to adopt that status now. That is substantially fewer than the 12 calendar-year plans projected to be “red” within five years based on the 2019 results. One of the two “early red” plans elected to be “red” for 2020.

What does the future hold for *your* plan?

A plan’s direction is as important as its current zone status. The actuarial zone status certification is based on a particular set of assumptions. There is a risk that emerging results will differ significantly from that set of assumptions, particularly this year.

The market crash of 2008–2009, and the events of 2020, remind us that a focus on risk is needed, even for well-funded plans. Projections of future contribution rates and the cost of differing benefit designs help to analyze the long-term sustainability of retirement programs. Your Segal consultant can discuss approaches to evaluate your plan’s financial condition and embedded risks to help you understand your options going forward.

Questions? Contact us.

For more information about the latest *Survey of Plans' Zone Status*, contact your Segal consultant or one of the following subject matter experts on multiemployer pension plans:

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