Segal Consulting

Survey

Benefits, Compensation and HR Consulting WINTER 2014

Survey of Plans' 2013 Zone Status

In 2013, a solid majority of multiemployer pension plans — 59 percent — were in the green zone,[1] according to Segal Consulting's *Survey of Plans' 2013 Zone Status*. This percentage represents a very slight decline from 2012 (60 percent). It is important to note that the survey, which is based on zone certifications due 90 days after the beginning of the plan year, only partially reflects the very positive investment performance of 2013.[2] Moreover, many plans are still recognizing earlier investment losses triggered by the 2008/early 2009 market downturn[3] and/or are in industries in which employment has not yet returned to pre-recession levels.

Despite those lingering challenges, the average Pension Protection Act of 2006 (PPA'06) funded percentage[4] for all surveyed plans was 84 percent in 2013, the same percentage as in 2012. The average PPA'06 funded percentage has been remarkably consistent in recent years — 87 percent in 2011, 83 percent in 2010 and 82 percent in 2009 — but was higher before the recession: 94 percent in 2008.

> "In 2013, a solid majority of multiemployer pension plans… were in the green zone."

Although the percentage of plans in the green zone has declined since 2011 (from 63 percent), by 2013 it was higher than in 2010 (53 percent) and dramatically higher than in 2009 (38 percent). One reason for the improvement since 2010 is the ongoing strengthening of the investment markets. For the nearly five years from April 1, 2009 (the bottom of the market) to December 31, 2013, the median return for Taft-Hartley pension funds with a 40 to 70 percent allocation to equities was 13.8 percent, according to

[1] The text box on page 5 provides background on the zones.

[2] In fact, the zone status of calendar-year plans is from certifications that were due by the end of March 2013 and only takes into account 2012 investment performance.

[3] 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 for Multiemployer Plans": http://segalco.com/publications/bulletins/july2010relief.pdf

[4] 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.

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.)

If the sunset occurs, the impact on plans that are in the green zone in their 2014 plan year is relatively clear. They 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 plans that are subject to this continuation clause is less clear. There are a number of important, unanswered questions. For example, "What does it mean for a plan to be 'operating under' an FIP or RP for its 2014 plan year?"

In expectation of the possible sunset and in light of uncertainty about the application of the continuation clause, trustees of plans that are likely to change zone status this year are advised to pay particular attention to the zone certification that is due 90 days after the beginning of the plan year (by March 31, 2014 for calendar-year plans). Plans that are entering into or are already in the yellow or red zone this year will want to make sure that they adopt or have in place their FIPs and RPs before December 31, 2014.

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).

About the Survey

The survey data is based on Segal Consulting zone certifications through November for more than 350 client plans representing a wide range of industries from across the country that have plan years beginning January 1 through September 1.* The certifications took into account any changes in plan design, employment, negotiated contribution rates and investment performance, through the end of each 2012 plan year.

* The survey does not include about 40 plans that have plan years beginning October 1 through December 31 because information on their zone certifications is not yet available. By spring 2014, those zone certifications will be finalized and a graph summarizing the 2013 zone status for plans with plan years beginning January 1 through December 31 will be available on the Segal website: www.segalco.com

"A large majority of plans in the survey (98 percent) do not anticipate a solvency problem over the next seven years."

Segal Rogerscasey (the SEC-registered investment solutions member of The Segal Group).[5] That rate of return significantly exceeds multiemployer plans' investment-return assumptions. Of course, from an actuarial perspective, a five-year period is a relatively short time frame. Further, trustees have taken steps to strengthen their plans as permitted by PPA'06.

Despite the slight decline in the percentage of plans in the green zone from 2012 to 2013, a large majority of plans in the survey (98 percent) do not anticipate a solvency problem over the next seven years. While insolvency — the inability to pay benefits within seven years — is one of the criteria for measuring zone status, this is significant because insolvency is the trigger for benefit reductions to PBGC-guaranteed levels. Trustees of many red-zone plans have reduced the likelihood of a future insolvency by taking advantage of the ability to adjust benefits.

Zone Status

Details about plans' 2013 zone status follow:

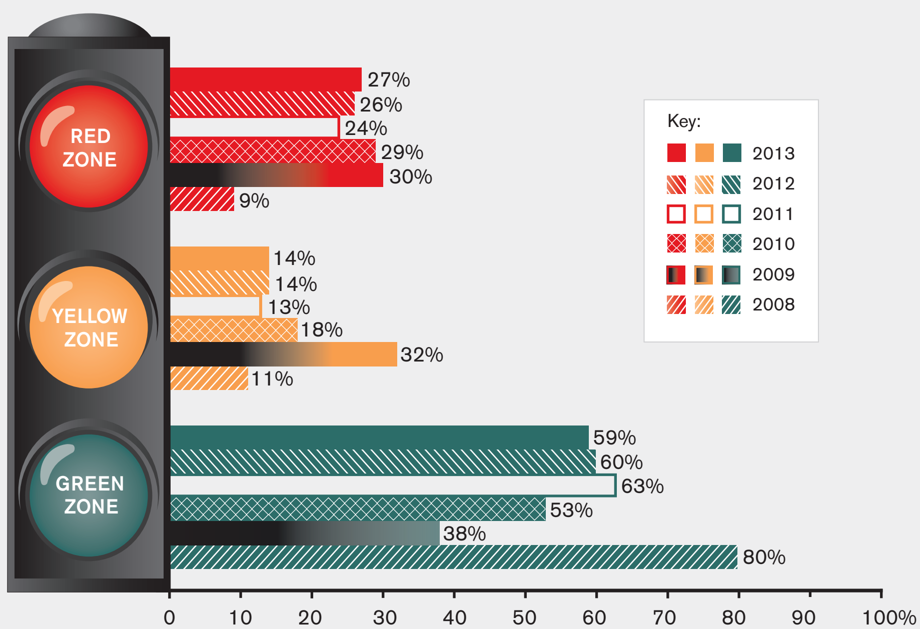
- ***For 2013, 59 percent of plans were in the green zone.*** As noted at the beginning of this report, this represents a modest decline from 2012 and 2011, but is higher than 2010 and 2009. This is still short of 80 percent, the percentage of plans in the green zone in the 2008 survey prior to the market downturn that began late that year.

- ***The percentage of plans in the yellow zone was the same for 2013 as for 2012: 14 percent.*** This is a greater percentage than was reported in the 2008 survey, when 11 percent were in the yellow zone.

- ***The percentage of plans in the red zone increased by 1 percentage point between 2012 and 2013.*** For 2013, 27 percent of plans were in the red zone, up from 26 percent in 2012. This is in sharp contrast to 2008, when only 9 percent of the surveyed plans were in the red zone.

Graph 1 shows the surveyed plans' 2013 zone status compared to the 2008 through 2012 survey results.

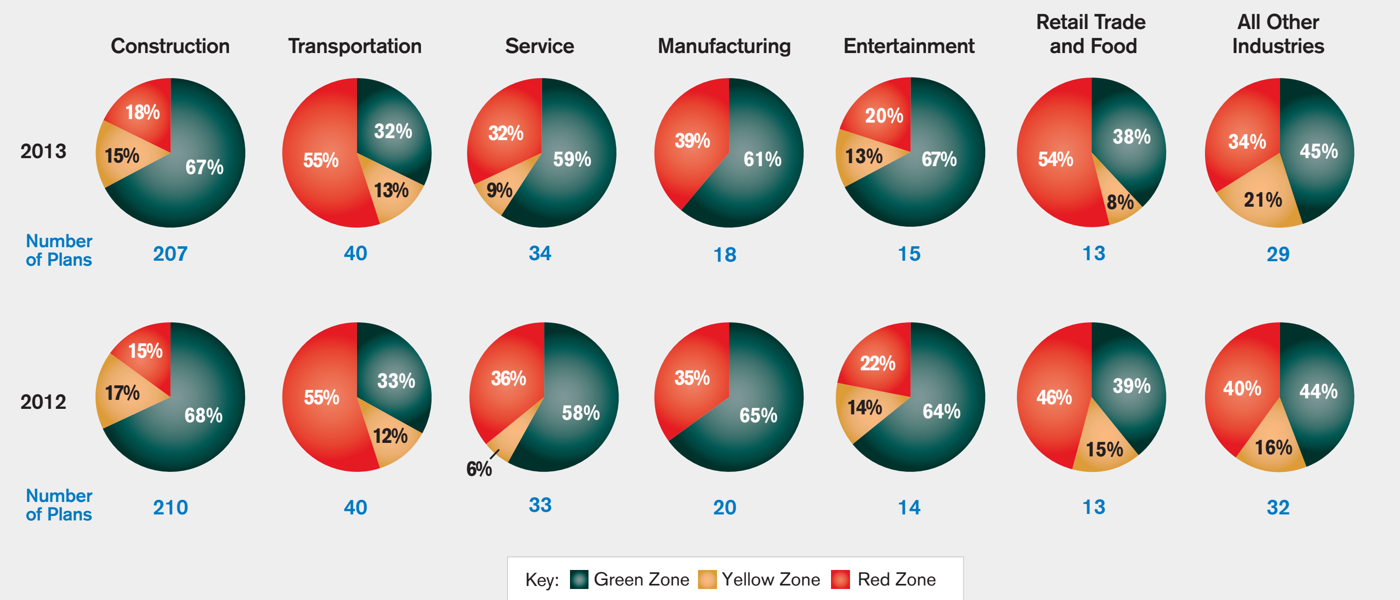
Graph 1: Breakdown of Plans' Certified Zone Status in 2013, 2012, 2011, 2010, 2009 and 2008 by Percentage of Plans in Each Zone*



* More than 350 plans are represented in all six surveys. 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/

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

Graph 2: Breakdown of Plans' Certified 2013 and 2012 Zone Status by Industry*



* The fewer the number of plans in a given industry, the less likely the results are to be indicative of an industry's overall status.

"As was the case in 2012, a majority of plans in each of the following industries were in the green zone in 2013: construction, entertainment, manufacturing and service."

The *Survey of Plans' 2013 Zone Status* shows industry differences in the plans' certified 2013 zone status. As was the case in 2012, a majority of plans in each of the following industries were in the green zone in 2013: construction, entertainment, manufacturing and service. The industry with the greatest percentage of red-zone plans continued to be transportation, with a nearly equal percentage of red-zone plans in the retail trade and food industry. For more details and the zone status of plans in other industries, see Graph 2.

"The average PPA'06 funded percentage for all surveyed plans was 84 percent for both 2012 and 2013."

The entertainment industry experienced the largest increase in the percentage of green-zone plans. The "all other industries" group experienced the largest decrease in the percentage of red-zone plans. The retail trade and food industry experienced the largest decrease in the percentage of yellow-zone plans and the largest increase in the percentage of red-zone plans. The manufacturing industry experienced the largest decrease in the percentage of green-zone plans and the second largest increase in the percentage of red-zone plans.

PPA'06 Funded Percentage

The average PPA'06 funded percentage for all surveyed plans was 84 percent for both 2012 and 2013. The bars in Graph 3 on the next page show a breakdown of the 2013 PPA'06 funded percentage for the plans in the survey. The percentage of the surveyed plans that had a PPA'06 funded ratio of at least 100 percent for 2013 was 17.4 percent, up from 16.3 percent one year earlier. The percentage of plans that had a PPA'06 funded ratio of less than 65 percent declined from 16.3 percent for 2012 to 15.5 percent for 2013.

The small pie charts in Graph 3 indicate the percentage breakdown of the certified zone status for the plans in each funded percentage range. Together, both sets of data illustrate

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the correlation between the PPA'06 funded percentage and zone status. However, it is important to remember that *no single measurement* is sufficient to determine a plan's zone status under PPA'06.

Commentary and Outlook

The results of Segal's *Survey of Plans' 2013 Zone Status* reveal that a solid majority of multiemployer pension plans were in the green zone. The average PPA'06 funded percentage has stabilized. There is another bright spot: 94 percent of the red- or yellow-zone plans that are now in their rehabilitation or improvement period reported meeting scheduled progress as defined in their RP or FIP.[6]

We anticipate improved funding percentages in 2014 and beyond as a result of the very positive investment performance in 2013. However, continued market volatility, as evidenced in early 2014, underscores the need for ongoing vigilance.

A plan's zone status for the plan year beginning on or after January 2014 (for calendar-year plans, that means the zone certification due by the end of March 2014) has even greater implications than in prior years, given uncertainty surrounding the scheduled

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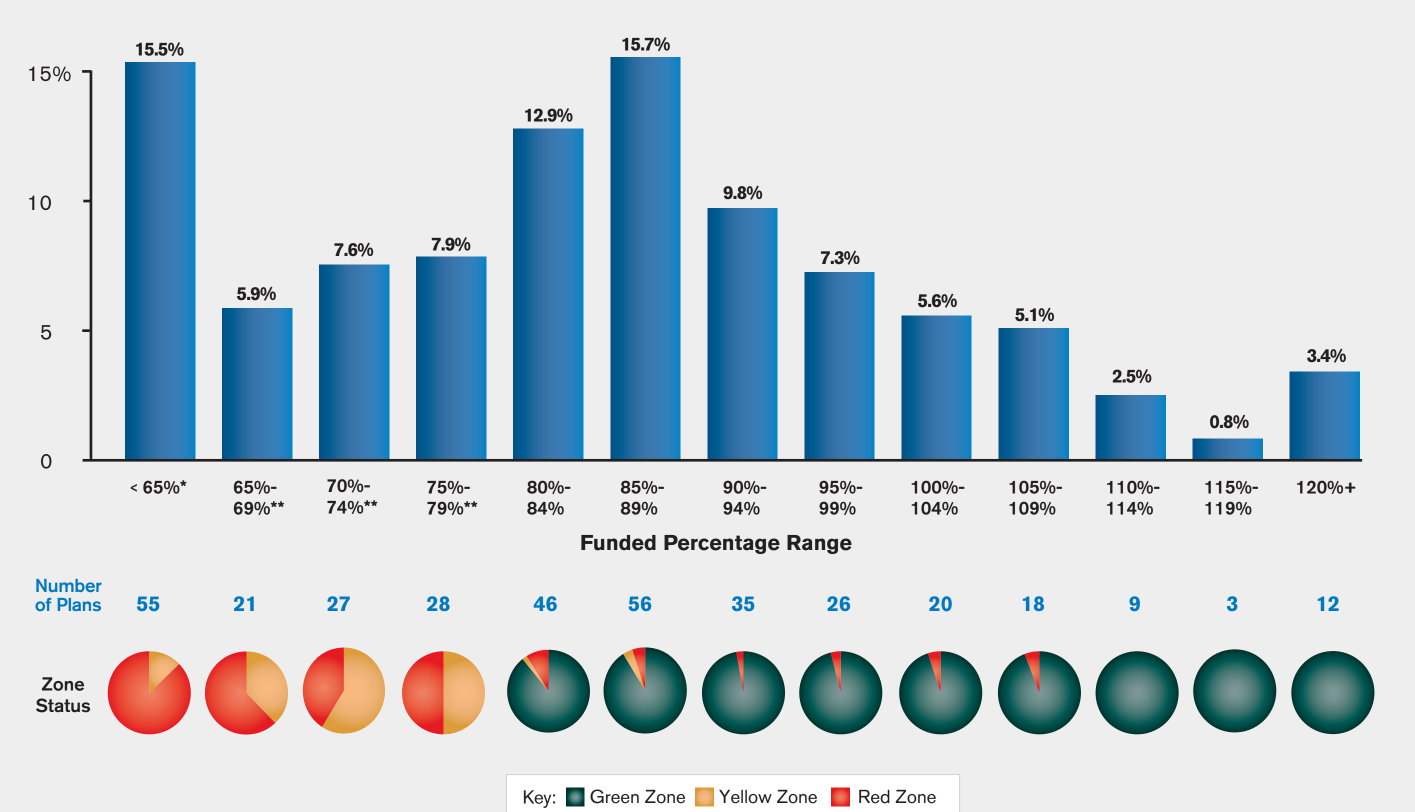
[6] RPs and FIPs are defined in "The Zones" text box on page 5.

Graph 3: Percentage, Number and Certified 2013 Zone Status of Plans by 2013 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.

The Zones

Under the funding 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 zone certification no later than 90 days after the beginning of the plan year. (For example, if the plan year began on January 1, 2014, certification is 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 operate within specific constraints and to take specific actions to improve the plan's financial status.* Those actions are detailed in a Funding Improvement Plan (FIP), which is for yellow-zone plans, or a Rehabilitation Plan (RP), which is for red-zone plans. Although the zone-certification rules are scheduled to sunset for plan years beginning after December 31, 2014, a pension plan operating under an FIP or an RP at that time will continue to operate under the FIP or RP.**

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 immediate 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 PPA'06 measurements, in order to monitor and manage their plans' financial condition effectively.

* The criteria for an emerging funding problem are summarized in a supplement to a previous zone-status survey report, which is available on the following web page: http://www.segalco.com/publications/surveysandstudies/zonesupp.pdf

** 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

"Although the zone-certification rules are scheduled to sunset for plan years beginning after December 31, 2014, a pension plan operating under an FIP or an RP at that time will continue to operate under the FIP or RP."

sunset of selected PPA'06 zone provisions at the end of 2014.

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. Trustees of some green-zone plans, if they have not already done so, may wish to consider similar actions to preserve that status. The survey data indicates that, over the next few years, almost 10 percent of the plans that were certified as green are projected by the actuary, in the absence of investment gains and assuming that the sunset deadline is extended, to migrate into the yellow or red zone unless corrective steps are continued or initiated. That percentage could decrease in 2014, given the positive investment returns in 2013. 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.

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The results of the *Survey of Plans' 2013 Zone Status* highlight how important it is for trustees to understand their plans' vulnerability to risks, such as investment risk (*i.e.*, the volatility of returns), employment risk (*i.e.*, an employment level that falls short of expectations) and longevity risk (*i.e.*, increased life expectancy), so that appropriate preemptive or corrective actions can be considered.[7] To assess

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[7] See Segal's February 2009 *NewsLetter*, "Multiemployer Defined Benefit Plans in a Time of Crisis: Keeping a Long-Term Perspective": http://www.segalco.com/publications/newsletters/feb2009.pdf

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 benefit changes, recommended changes in contribution rates to the bargaining parties and changes to the investment policy.

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Segal consultants and actuaries, 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 using real-time modeling.

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

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