Economic Impact of COVID-19 Affects Multiemployer Pension Plans

Zone Certifications for Plan Years Beginning February Through July 2020

Segal

The economic impact of COVID-19 affected multiemployer pension plans in Segal's latest survey, which covers plans with plan years that begin from February 1, 2020 through July 1, 2020. Compared to one year earlier:

- The number of plans with a projected minimum funding deficiency within the next 10 years grew by almost 25 percent.
- The percentage of plans in the green zone remained level.
- The average funded percentage was 84 percent, down slightly from 85 percent in 2019. The decline in the funded percentage was muted because of asset smoothing.
- The industry activity assumption for most plans was the same or close to the same as in their prior year's zone certification.

Note that these findings reflect the short-term economic impact of the COVID-19 pandemic on financial markets and employment levels through the actuarial certification date (from April 1, 2020 through September 30, 2020). There have been extreme fluctuations in market values during the COVID-19 pandemic, with dramatic declines through April 30, and increases during May and June. The market rebounded to pre-COVID-19 levels in the later months of 2020. The generally favorable market returns after June 30 are not reflected in the zone status certification results of this survey.

About the survey

The survey includes 93 plans (approximately one-quarter of all plans for which Segal is the actuary). As a group, these plans have nearly $75 billion in assets and provide benefits to more than 1.2 million participants.

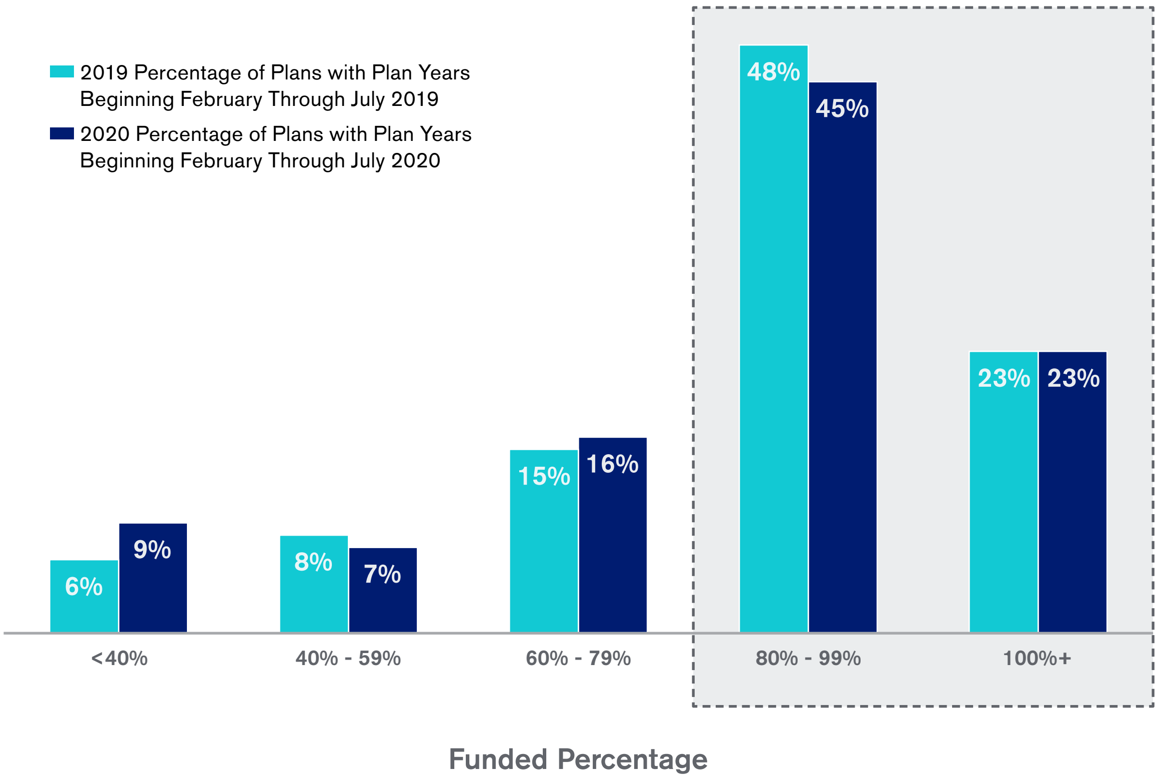
To identify changes since 2019, we looked at experience for the same plans.

(The results of our previous survey, which was published in spring 2020, were for calendar-year plans. Because they were based on actuarial certifications as of January 1, 2020, they were not impacted by the COVID-19 crisis, which began having a dramatic impact on markets partway through the first quarter.)

Changes in funded percentages

More than two-thirds of plans with February through July plan years have a Pension Protection Act of 2006 (PPA'06) funded percentage (i.e., the ratio of the actuarial value of assets to present value of the accrued benefits) of at least 80 percent or more. That is lower than the 2019 results for the same group of plans. A funded percentage of at least 80 percent is one of the requirements to be in the green zone.

Percentage of Plans by Funded Status: Plans that Are at Least 80 Percent Funded Decreased from 71 Percent to 68 Percent



Source: Segal, 2021

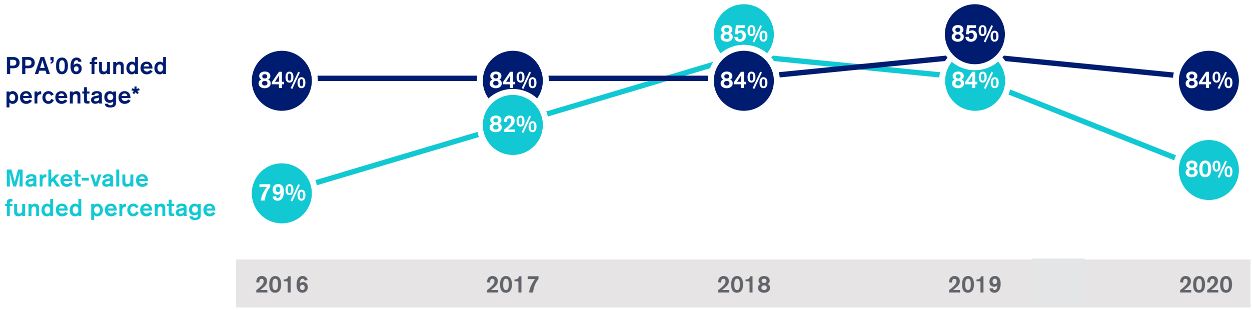
Although a number of factors will affect the funded percentage, investment returns are a primary driver. Investment returns that are lower than expected will have an adverse effect on funded percentage while better than expected investment returns will improve the funded percentage. The average market-value rate of return (net of investment expenses), was 17 percent for the 2019 calendar year and was less than zero from January 1, 2020 through June 30, 2020 (the investment experience taken into account for the plans in this study). Market returns have generally been favorable since June 30, 2020.

Asset smoothing stabilizes PPA'06 funded percentage

Asset smoothing allows plans to spread out the effects of any single year of investment performance over multiple years. Smoothing typically occurs over five years, though the maximum period has been extended in the past via legislative relief in response to economic downturns.

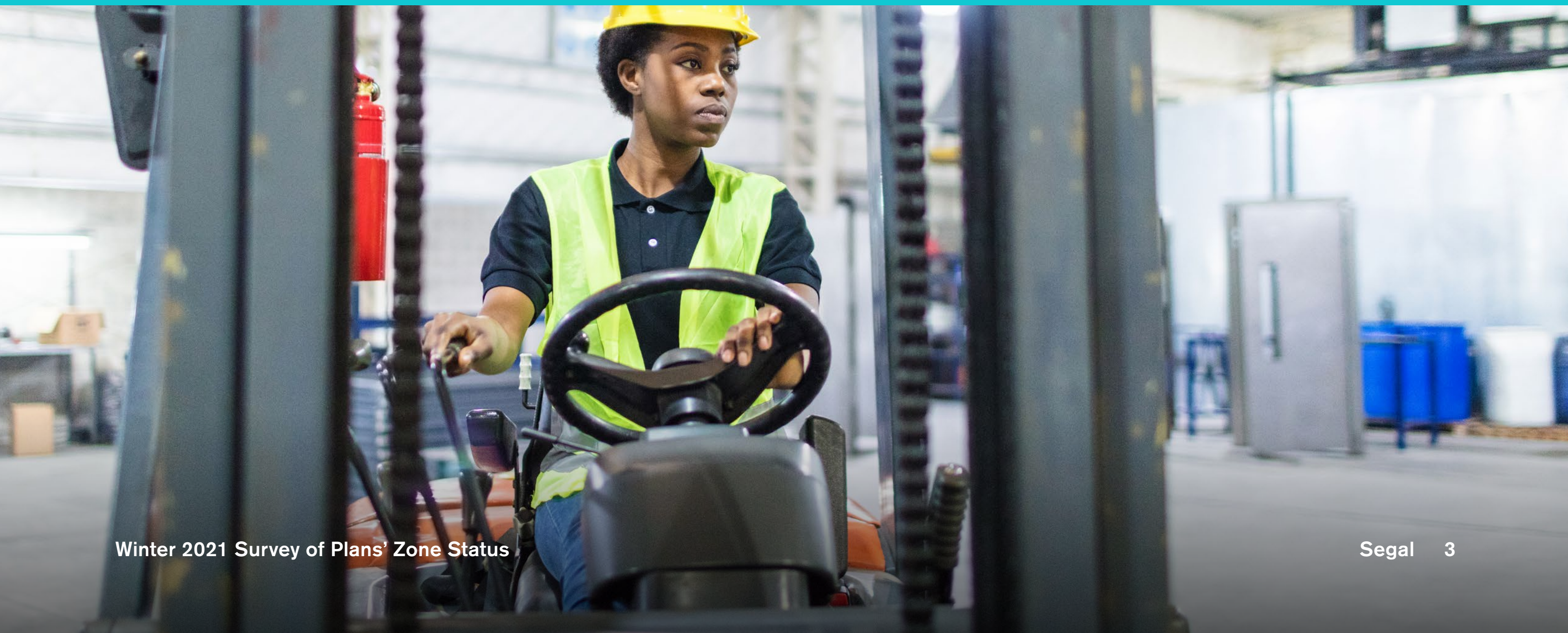
Over the past five years, the market-value funded percentage increased by as much as 3 percentage points and decreased as much as 4 percentage points from one year to the next. In contrast, because of smoothing the PPA'06 funded percentage never changed by more than 1 percentage point. A more stable funded percentage allows the trustees to plan for the future and allows collective bargaining parties time to anticipate changes in contribution rates.

Effectiveness of Asset Smoothing on the Funded Percentage of Multiemployer Plans with February 1 through July 1 Certification Dates



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

Source: Segal, 2021



More plans are facing a projected minimum funding deficiency

The results of the latest survey show more plans are facing a projected funding deficiency than in prior years. Although the number of plans is relatively small, this is an early indication that more plans may enter endangered or critical status in the years ahead.

With most plans experiencing investment gains in the latter part of 2020, it is likely that the impending funding deficiency will be deferred when the 2021 results are determined. If that is not the case, the impending deficiencies may cause more plans to enter into endangered or critical status in the next few years.

Increase in the Number of Plans Facing a Projected Funding Deficiency

	Immediate	Within 7 Years	8–10 Years	10–20 Years	Total
2019	14	5	3	3	25
2020	15	5	7	4	31

About zone status

A plan's zone status is based on a series of measurements. The two primary factors are the funded percentage and maintenance of the funding standard account credit balance.

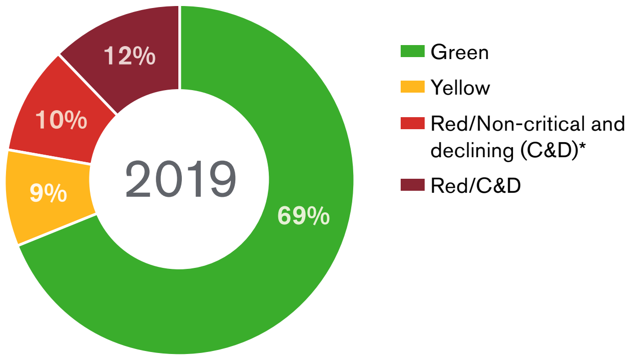
The funded percentage is a point-in-time measure and, since it uses the actuarial value of assets, only a portion of the market-value investment experience is reflected. However, the full impact of market-value returns is reflected in projecting the funding standard account credit balance forward.

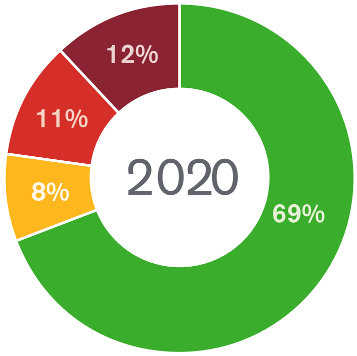
To be in the green zone, a plan must have a projected credit balance, rather than a funding deficiency, at the end of seven years.

The zone status of plans remained stable

The zone-status breakdown for plans in the survey shows no material changes in the percentage of plans by zone since last year. Only one plan moved between zones since the prior year (from yellow to red).

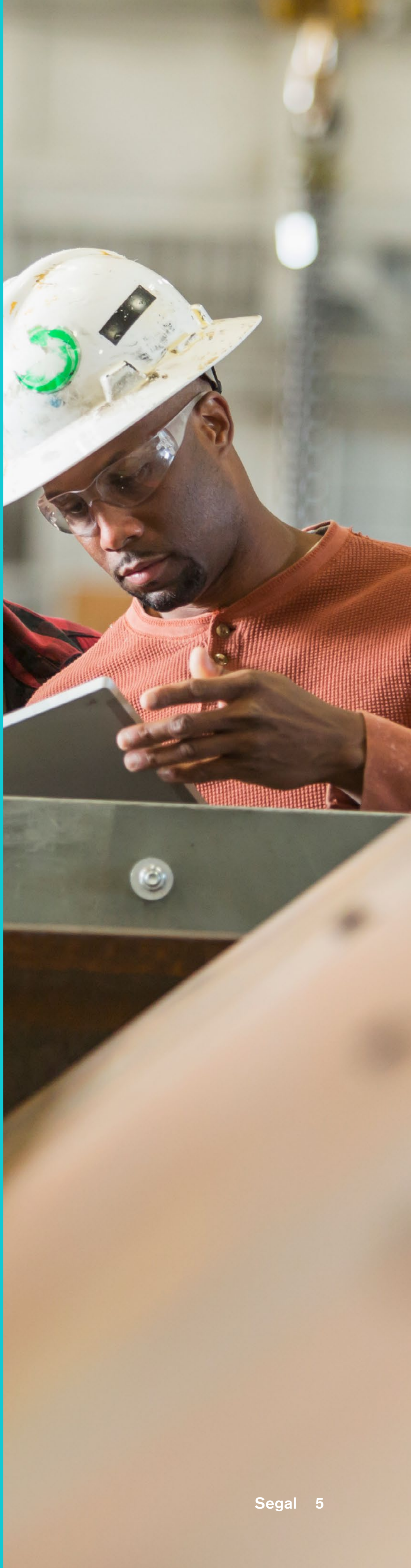
2020 Distribution of Zone-Status Results Similar to 2019





* C&D plans are generally those where the actuary has projected the plan assets to be completely exhausted within 20 years.

Source: Segal, 2021



Looking ahead in uncertain times

Of the plans in the survey that were certified as “green” or “yellow,” four plans (three green-zone plans 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. In the 2019 survey of these plans, only two plans were projected to be “red” within five years. None of the four “early red” plans in this 2020 survey elected to be red this year (and one of the two early red plans elected to be red last year).

Changes in industry activity assumptions

A leading indicator of the future financial condition of a multiemployer plan is the industry assumption. This assumption is based on input from the plan trustees and may reflect both short-term and long-term employment expectations, including the number of active employees and the total contribution base.

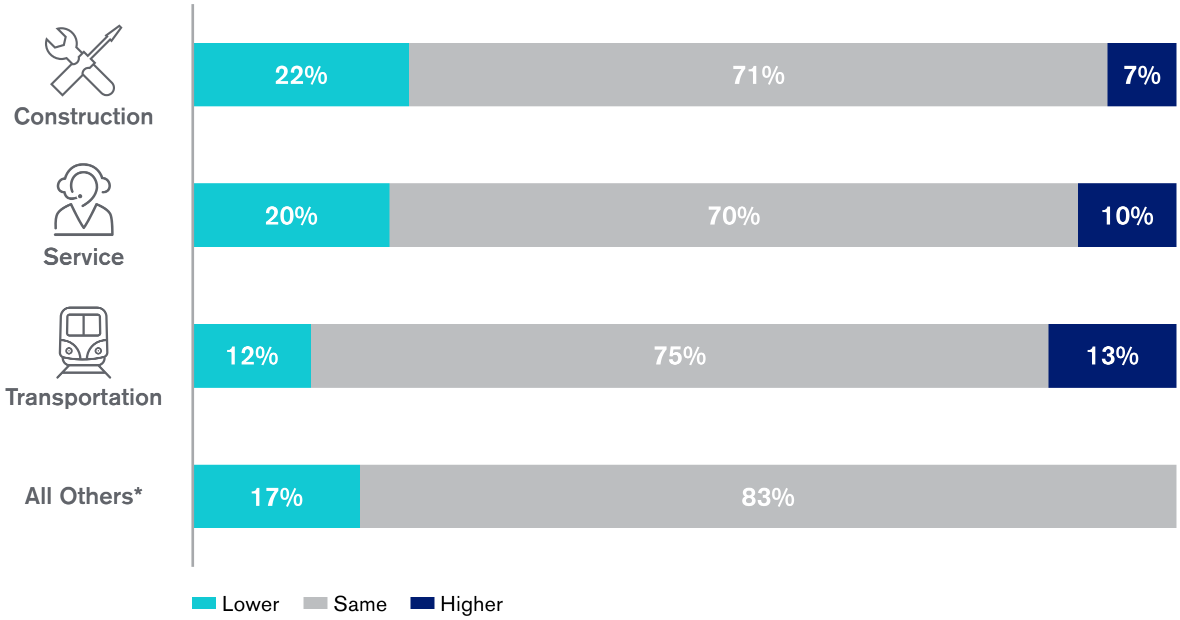
The industry activity assumption for most plans was the same or close to the same as in the prior year’s zone certification. However, over 20 percent of the 79 construction and service industry plans in the survey used a lower industry assumption for the 2020 certification, as did 14 percent of plans in all other industries combined.

Around one-third of the plans that changed their industry assumptions specifically stated the COVID-19 pandemic as the reason. As the pandemic continues into 2021, we anticipate there will be more plans that reevaluate their short-term and long-term industry assumptions for the 2021 zone-status certifications.

COVID-19 has had a disproportionate impact on some communities, workers and industries. Some industries such as construction and entertainment generally anticipate slow or partial recoveries. Other industries may never fully recover. The industry levels have a direct impact on a multiemployer plan’s future contribution expectations.

As the zone certifications in this survey were coming due, plan trustees were doing their best to provide input on employment in the midst of unprecedented uncertainty. The input they provided for the 2020 certifications may or may not represent their current expectations. Many plans are engaging in detailed risk assessments focused on potential industry levels and investment returns to enable them to understand the implication of adverse scenarios on the funding outlook and zone status.

Change in Industry Activity Assumptions for February 1 through July 1 Plan Years Compared to Prior Year



* This includes entertainment, manufacturing and retail, trade & food.

Source: Segal, 2021

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 economic turmoil in financial markets and industry shutdowns of 2020 demonstrate that a study of risks, and possibly even black-swan events, is useful in reaching strategic decisions, even for well-funded plans. Projections of industry levels, their potential impact on future contribution rates and consideration of alternative benefit designs help to analyze the long-term sustainability of retirement programs. Segal consultants can discuss approaches to evaluate your plan's financial condition and inherent risks, and can 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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