Segal Consulting

ideas

Trusted Advice for Multiemployer Plans

April 2016

# Neither DB nor DC: The Composite Plan

Congress may soon consider legislation for a new type of shared-risk multiemployer retirement plan known as a Composite Plan. This design was initially proposed in the NCCMP 2013 Retirement Security Review Commission Report, *Solutions not Bailouts*,[1] but was not enacted as part of the Multiemployer Pension Reform Act of 2014 (MPRA). This issue of *Ideas* summarizes key points of the Composite Plan design. In addition, it presents the results of our stress testing of a hypothetical Composite Plan.

## What Is a Composite Plan?

The Composite Plan's key distinguishing features, based on the currently drafted provisions, are described below:

- It is neither a defined benefit (DB) nor a defined contribution (DC) plan but rather is composed of features of both types of plans (hence the name), while mitigating the shortcomings of each.
- The shared-risk design is intended to provide funding stability, provide lifetime income to participants and promote employer participation.
- It has a benefit structure like a DB plan.
- Similar to a DC plan, the employers' obligation is limited to negotiated contributions.

### Aspects of the Composite Plan Design Similar to DB Plans and DC Plans

**DB-like structure:**

- The trustees establish the accrual rate and the eligibility provisions.
- Benefits are paid as annuities.
- Vesting provisions and spousal requirements are included.
- Ancillary benefits, such as disability and death benefits, may be offered.

**DC-like features:**

- Contribution rates are negotiated by the bargaining parties.
- Accrued benefits may be reduced under certain conditions.
- There is no withdrawal liability.
- There are no PBGC guarantees or premiums.

[1] This is called the "Target Benefit Plan" design in the NCCMP report.

> There are strict limits on the level of allowable benefit improvements.

### Ground Rules for Establishing a Composite Plan

At inception, contributions to a Composite Plan have to be at least 120 percent of the cost of providing the benefit.

If added to an existing DB plan, the assets in each component must be segregated and can only be used to provide benefits for that component.

- The existing DB plan will be frozen and could apply for special funding relief.
- Withdrawal liability relief may apply when the existing DB plan becomes "fully funded."

- A Composite Plan can be established as a stand-alone plan or as an add-on component to an existing DB plan, as noted above.
- The funding requirements of a Composite Plan are based on a 15-year forward-looking projection (based on the actuary's best-estimate assumptions), with a target projected funded ratio of 120 percent in 15 years.
- There are strict limits on the level of allowable benefit improvements: They are only allowed if the projected funded ratio is at least 120 percent after the improvement. To mitigate "overspending" excess reserves, benefit improvements on benefits attributable to prior service are generally limited to 2.5 percent to 5 percent.
- Should financial difficulties occur (*e.g.*, the 15-year projected funded ratio is less than 120 percent), the trustees must establish a realignment program,[2] which they must monitor and update annually. Realignment program remedies are described below.

### Realignment Program Remedies

Initial remedies in a realignment program include recommended contribution rate increases that could be negotiated by the bargaining parties, future accrual rate reductions, and reductions in "adjustable" benefits for non-retirees (*e.g.*, early retirement subsidies and optional forms).

Upon exhausting all reasonable initial remedies, subsequent remedies can include reductions in accrued benefits to non-retirees and reductions in "non-core" retiree benefits (*i.e.*, benefits beyond the accrued benefit at Normal Retirement Age).

If despite all reasonable measures, the plan is projected to be insolvent within 25 to 30 years, "core" retiree benefits can also be reduced.

[2] This is analogous to plans having a Funding Improvement Plan if they are in Endangered Status or a Rehabilitation Plan if they are in Critical Status, as defined by the Pension Protection Act of 2006 (PPA'06).

**Protections for Legacy Plans**

Existing ERISA rules for the DB plan continue to apply to the legacy plan, including PPA'06 certifications, MPRA provisions, PBGC premiums and employer withdrawal liability.

There is a "transition minimum" required contribution to a legacy plan that could be larger than the current statutory requirements.

Contributions to the legacy plan will continue for all employees (*i.e.*, employers cannot exclude any group of younger or newly hired employees when determining the contributions owed to the legacy plan).

- The draft legislation includes provisions to protect the existing multiemployer DB plans that become characterized as "legacy" plans when a Composite Plan is established, as noted above.

It is too soon to know when legislation may be introduced or enacted. It is important to note that the provisions outlined above are based on a preliminary draft version of the legislative language and are likely to differ from the version introduced and, ultimately, the version enacted.

## How Would a Mature Composite Plan Recover from Severe Shocks?

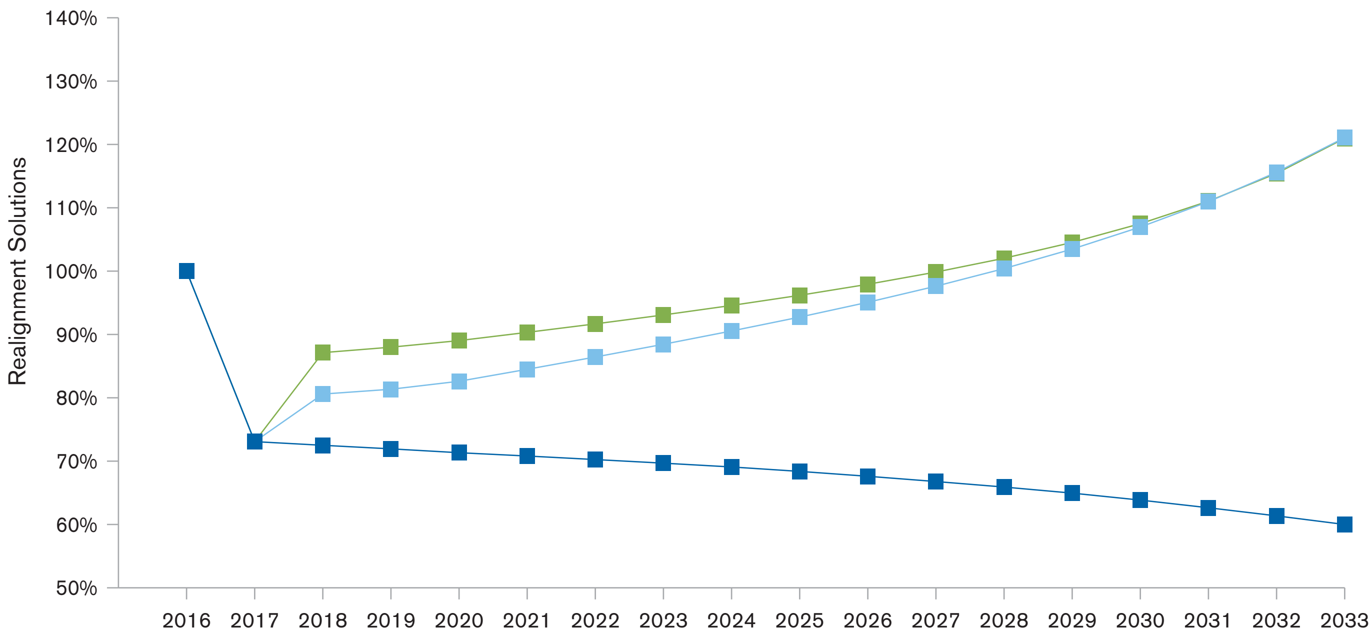
In the first year, the funded percentage is intended to be 120 percent as contributions must equal 120 percent of the cost of benefits accruing. As described above, there are strict limits on the ability to improve benefits and early intervention is required to mitigate the impact of adverse experience. These protections were put in place to recognize the lessons learned after the "Great Recession."

To assess the ability of a mature Composite Plan to recover from severe shocks similar to those that DB plans experienced in the 2008–2009 period, Segal Consulting performed an analysis evaluating the level of remedies that would be required to restore a plan to its required projected funded ratio of 120 percent in 15 years. Included in our stress-testing was a severe investment loss of –22 percent (mirroring the average

> "Existing ERISA rules for the DB plan continue to apply to the legacy plan, including PPA'06 certifications, MPRA provisions, PBGC premiums and employer withdrawal liability."

plan's rate of return for 2008), as well as combining that loss with a 25 percent employment decline (as was experienced in some industries following 2008), each with no immediate recovery. The starting point was presumed to be a 100 percent funding level, due to prior adverse experience, with the effect of the shocks taking that down to 73 percent (and projected to decline further). The following graph illustrates typical realignment solutions that would be available to trustees in these circumstances.

### Results of Segal's Stress Test




**Initial Certification:**

- -22% return in 2016
- 25% contraction in active population
- Funded percentage declined from 100% in 2016 to 73% in 2017
- Projected funded ratio of 60% in 15 years

**Realignment Program #1:**

- Negotiate 54% increase in contributions spread over three years
- 30% reduction in future accruals
- Remove all non-core non-retiree benefits (15% reduction on average)
- 6% reduction in non-core retiree benefits
- Projected funded ratio of 121% in 15 years

**Realignment Program #2:**

- Negotiate a 16% increase in contributions spread over three years
- 30% reduction in future accruals
- Remove all non-core non-retiree benefits and 4% reduction to core non-retiree benefits (19% reduction on average)
- Remove all non-core retiree benefits (15% reduction on average)
- Projected funded ratio of 121% in 15 years

Source: Segal Consulting, 2016

> Segal's analysis provides an illustration of the ability of a Composite Plan to recover from a severe shock, based on timely, aggressive plan trustee management.

Segal's analysis provides an illustration of the ability of a Composite Plan to recover from a severe shock, based on timely, aggressive plan trustee management. Such action would be required under the proposal — even for a very mature plan, where shocks are more difficult to absorb. For plan sponsors considering implementation of a Composite Plan, more robust modeling and analysis will be necessary, specific to each plan's circumstances. This plan-specific analysis should take into consideration factors such as participant demographic characteristics, contribution levels, legacy plan costs, core- and non-core benefit levels, other plan design features, as well as the plan sponsor's risk tolerance and investment philosophy.

## What's Next?

As noted, this *Ideas* is intended to be a high-level summary of the Composite Plan legislation as currently drafted as well as to provide some context for the ability of a plan to recover from significant adverse experience. When — and if — the legislation works its way through the legislative process, Segal will provide additional details and updates.

## Questions? Contact Us.

For more information about the Composite Plan design, contact your Segal benefits consultant, the nearest Segal office or one of the following experts:


Diane Gleave
212.251.5185
dgleave@segalco.com

Eli Greenblum
202.833.6480
egreenblum@segalco.com

Aldwin Frias
212.251.5188
afrias@segalco.com


To receive *Ideas* and other Segal publications, join our email list.

Segal Consulting is a member of The Segal Group.