Article from

Retirement Section News

October 2020

Review of Multiemployer Plans: An Interview with Cary Franklin

By Patrick Ring

Author's note: Cary Franklin is a consulting actuary with Horizon Actuarial Services, LLC, based in Los Angeles. Cary has been a consulting actuary for more than 40 years and his work is now almost exclusively focused on multiemployer pension plans

Over the last couple of years, multiemployer plans have been in the limelight because of their dire financial situation when compared to single employer plans. This situation has gotten the attention of Congress. This article explores aspects of multiemployer plans that differ from single employer plans and educates the reader on why some multiemployer plans are prone to being in a worse financial situation than are single employer plans, especially in this pandemic period.

I am pleased to interview Cary Franklin to shed light on the above mentioned topic.

Patrick Ring (PR): How did you get involved with multiemployer plans, and how has your work with them changed over time?

Cary Franklin (CF): My career began one year after the passage of ERISA, at a consulting firm with a large multiemployer pension plan practice, as well as a single employer plan practice. I worked with both multiemployer and single employer plans for many years but always preferred working with the multiemployer plans for several reasons. First, multiemployer plans are less static than single employer plans—benefit levels and designs are constantly being evaluated and changing. Second, the politics of multiemployer plans are always interesting, given that the plan sponsor is a board of trustees equally represented by management and labor so that the actuary must remain objective amidst diverse and frequently opposing viewpoints. Third, the pension plan is the client, rather than the plan being just one small aspect of a client's business. As such, the trustees and professional service providers are focused on the plan itself with minimal distractions.

Over time, the plans and the issues they face have become more numerous and complex—evolving benefit designs, frequent legislative changes, funding challenges as the plans have matured, and the fallout from the Great Recession. As a result, I've seen the actuary's role expand, with a much greater emphasis on consulting skills as opposed to purely technical skills, and a significantly increased reliance on projections (both deterministic and stochastic) as a problem-solving tool.

PR: To the casual observer, multiemployer plans look pretty much the same as single employer plans except that they cover workers from more than one employer. However, they actually work very differently. What makes them so different, and what does that mean?

CF: One key difference is that the contributions drive the benefit levels, rather than the other way around. For the vast majority of plans, contributions (which are typically based on units of work, such as hours) are set through collective bargaining, typically for periods of up to three years or longer. Since

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contributions cannot be easily adjusted from year to year, as they are in single employer plans, the actuary must determine, through annual valuations and multi-year projections, whether the anticipated contributions will support the plan's benefits. If not, something must be adjusted—either the benefits, which are typically controlled by the plan sponsor (the board of trustees), or the contributions, through the collective bargaining process. The actuary must constantly monitor the balance between anticipated contributions and promised benefits.

For most, but not all, multiemployer plans, benefits are not pay-related; instead they are based either on service or contributions. Plans with multiple contribution rates that vary by job category or by employer (common in the construction industry) will often define benefits as a percent of contributions, e.g., a monthly annuity benefit of 1 percent of annual contributions. This benefit design poses a challenge when funding problems occur, since if contribution rates are increased to address a funding shortfall, the benefit liability will also increase, unless the contribution increase is specified as non-benefit accruing.

Conventional wisdom says that the employer bears the investment risk in defined benefit plans and the participant bears the risk in defined contribution plans. But in multiemployer defined benefit plans the investment risk is effectively shared by both the employers and the participants. When adverse investment (or other) experience occurs, the funding correction might come from a negotiated increase in employer contributions, but it can just as easily come from a reduction in benefit levels or by the union allocating a portion of its negotiated wage package to increased contributions.

Another key difference between multiemployer and single employer plans is the shared governance between labor and management. Since the participating unions share the board of trustees' seats with the contributing employers, the plans' participants are represented in the operation of the plans in a way that doesn't occur in single employer plans.

Lastly, the funding rules for the two types of plans are very different. Prior to the Pension Protection Plan of 2006 (PPA), the funding rules were similar for multiemployer and single employer plans, but the PPA made significant changes. The biggest change is that the interest (discount) rate and mortality assumptions for single employer plans are now prescribed by law, with the interest assumption based on bond interest rates. For multiemployer plans the actuary selects all the assumptions, with the interest assumption still based on the expected long-term return on the plan's assets, as it was for single employer plans before the PPA. Multiemployer plan actuaries generally see this as a more rational approach to funding, where the measurement of the benefit liabilities is still connected to the anticipated investment earnings of the assets backing the benefit promise.

PR: I've heard that some multiemployer plans are in much worse financial condition than single employer plans. What is the reason for this?

CF: About 10 percent of the 1,300 or so U.S. multiemployer plans are in "critical and declining" status, meaning that they are projected to become insolvent within 20 years. The other 90 percent of the plans are either in good financial condition or they have taken steps to improve their funding. The difference between these two groups of plans, in most cases, is that the plans headed toward insolvency do not have the work levels, and thus the contribution income, necessary to make up the funding shortfalls before the plans become insolvent.

Our research has shown that the key driver of the critical and declining status is the deterioration in plan demographics, namely worsening ratios of inactive to active participants over time. Since contribution income is based on work performed by active participants, this ratio is a good indicator of a plan's ability to fund already accrued benefit obligations with future contributions. When plans incur significant losses, such as the massive investment losses during the Great Recession, plans with relatively smaller contribution bases have a much harder time recovering.

For all multiemployer plans, the median inactive to active ratio is roughly 3 to 2. For critical and declining plans, the median ratio is more than 6 to 1. With this much of a burden on the active participant contribution base, contribution rates cannot not be increased to the level needed to make up the underfunding without jeopardizing the financial stability of the plan's industry.

The critical and declining plans are concentrated in two industries: trucking and manufacturing. A combination of factors has led to the worsening demographics and projected insolvencies:

- Deregulation of the trucking industry (starting in the 1980s)
- Decline in U.S. manufacturing jobs
- Investment losses in the Great Recession
- Benefit levels that may have been stretched to unsupportable levels

PR: How has COVID-19 affected multiemployer plans? From what you've seen, what are the key drivers in how severely a plan has felt an impact?

CF: Of course, we're still in the middle of the pandemic, so we don't know what the ultimate impact may be. In March it looked like we might be headed for investment losses like those in 2008, but the investment markets have recovered reasonably well through August.

The other impact is the loss of contribution revenue due to decreased work levels. This impact has varied significantly by industry—work levels are stable or slightly higher in the retail

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food industry and stable to modestly lower in the construction industry (which accounts for about 60 percent of all multiemployer plans). At the other end, the hotel-restaurant and entertainment industries have seen drastic reductions in work levels and contributions. It's too soon to tell what the lasting impact of this crisis will be on these plans.

PR: At a high level, what kinds of potential federal law changes are in the works?

CF: There have been efforts for the last six or so years to address the pending insolvencies of the critical and declining plans, the largest of which will occur within five years. The "benefit suspensions" provided in the Multiemployer Pension Reform Act of 2014 (MPRA), where severely troubled plans can apply to the Treasury Department for approval to reduce current benefits, have been both controversial and largely ineffective as relatively few suspensions have been approved. In 2018 Congress convened the Joint Select Committee on the Solvency of Multiemployer Pension Plans to solve the critical and declining plan problem (as well as the projected insolvency of the PBGC's multiemployer plan insurance program, which would follow shortly after the large plan insolvency expected by 2025), but that Committee was unable to reach agreement on legislation.

The House Democrats' HEROES Act (proposed earlier this year) includes provisions to help the critical and declining plans by allowing them to transfer certain benefit liabilities to the PBGC (with corresponding government funding provided to the PBGC) so that the plans can remain solvent. The HEROES Act also includes funding relief provisions for all multiemployer plans like those enacted in the wake of the Great Recession. The prospects for passage of the HEROES Act are not good at this moment.

For all multiemployer plans, there have been several efforts (by opponents of multiemployer plans) to mandate lower assumed discount rates, as under the single employer plan rules. Such a change would be disastrous for most multiemployer plans, given the relationship between benefit levels and contribution rates that I mentioned earlier. So far, these efforts have been successfully thwarted, but the threat is still looming.

PR: In closing, is there anything else you would like to share with us regarding multiemployer plans?

CF: The multiemployer pension system has been a reliable system of retirement income for many decades. More than 10 million participants and their families benefit from the system, at a time when private sector defined benefit plans are in decline and the U.S. is at the beginning of a severe retirement income crisis. Roughly half of the U.S. private sector workforce has no access to workplace retirement benefits, not even a matched 401(k) plan, whereas the multiemployer system continues to provide benefits to newly hired workers. While the system faces various challenges, the significant majority of plans are financially sound and well managed—the participants of these plans are among the relatively few in this country who can count on lifetime retirement income from a defined benefit pension plan. ■

Patrick Ring, ASA, volunteers as a member of the SOA Retirement Section Council's Communications Team. In addition, he assists the SOA in fine-tuning and optimizing the Retirement Section's web page on SOA.org. He can be reached at *pringactuary@gmail.com*.

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