Multiemployer defined benefit pension plans can effectively manage pension risk through policies governing benefit design, funding and investments.

Managing Pension Risk

by | Cary Franklin
Traditional defined benefit (DB) plans in general, and multiemployer DB plans in particular, have faced criticism as being too risky to remain sustainable in the long term. This criticism began with the market downturn following the late 1990s bull market after many multiemployer plans needed to improve benefits to ensure the deductibility of employer contributions.

Several large multiemployer plans facing insolvency in the not-too-distant future have received much press and have motivated various legislative efforts. The benefit suspension provisions of the Multiemployer Pension Reform Act (MPRA), which were intended to save these severely troubled plans, have been ineffective at providing relief, since the available benefit reductions are often insufficient and few applications for suspensions have been approved.

At the same time, roughly two-thirds of the more than 1,300 U.S. multiemployer DB plans are in the green zone under the Pension Protection Act (PPA), and many of the yellow and red zone plans are on their way to improved financial health and long-term sustainability. How have these plans weathered the various storms that have hit the multiemployer pension system over the past two decades? The short answer is that they have successfully managed their risks. This article explores the ways in which pension risk can be effectively managed through three key policies: benefit design policy, funding policy, and investment policy.

Pension risk management seeks to increase the likelihood that plans will be sustainable over the long term, with a relatively stable balance between contributions and benefits. The more effectively each plan manages its risks, the more stable and sustainable the multiemployer system will be as a whole.

What do we mean by pension risk? Traditionally, risk has been viewed solely as the volatility of investment returns. But plans face many different risks in addition to investment return volatility, including the following.

- **Contribution base risk:** The contribution base (e.g., hours on which contributions are based) declines due to weakening work levels, competitive market conditions or employer withdrawals.
- **Longevity risk:** Participants live longer than assumed, with benefit liabilities becoming greater than assumed.
- **Employer withdrawal liability risk:** Employers withdraw and are assessed withdrawal liability (employer’s risk perspective), or withdrawn employers do not pay their obligation (plan’s risk perspective).
- **Pension Benefit Guaranty Corporation (PBGC)-related risk:** PBGC premiums increase significantly, or PBGC becomes insolvent.
- **Benefit adequacy risk:** Plan benefits do not meet participants’ needs, causing them to seek employment elsewhere or to remain employed beyond the age that employers would prefer they retire. This includes the inflation risk, which is when benefits do not keep pace with cost-of-living increases.
- **Excise tax risk:** A red zone plan fails to make scheduled progress in its rehabilitation plan, exposing the employers to excise taxes on funding deficiencies.

Some of these risks fall primarily on the participants (e.g., benefit adequacy), and some fall primarily on the employers (e.g., withdrawal liability, excise tax), while others are shared by the employers and participants collectively as sponsors of multiemployer plans. All of these risks are connected through the interaction of benefit design, investments and funding (Figure 1). Addressing one risk may aggravate a different risk. For example, reducing investment volatility by going to a more conservative asset allocation may increase the risk that benefits be-
come unaffordable or inadequate. The challenge is to find the optimal risk balance.

**Defining the Policies**

Benefit design policy addresses these questions (among others):

- Are the promised benefits adequate to secure the participants’ retirements?
- How are the benefits allocated among participants?
- Who has the investment risk under the benefit design?
- Are lifetime benefits available?

A funding policy establishes a formal connection between contributions and benefits.

- Under what favorable conditions may benefits be improved or contributions reduced?
- Under what unfavorable conditions must corrective action be taken—benefit reductions or contribution increases?

The Employee Retirement Income Security Act (ERISA) requires every plan to have a funding policy and to disclose it in the annual funding notice. However, in practice, funding policies tend to be minimally designed by most plans solely to comply with the ERISA rule—This minimal approach misses an opportunity to manage plan risks.

Investment policy is typically the policy that gets the most attention and covers:

- How much investment risk is tolerable?
- What is the optimal asset allocation?
- Who controls the investments?

Too often, the investment policy is developed and adjusted without regard to the other two key policies; that is, the investments are viewed in a vacuum without regard to the impact on plan funding or benefit design.

None of the policies operates effectively independently of the other two. Here are two examples to illustrate this point:

- A more aggressive investment policy means greater investment return volatility and risk of underfunding, thus increasing the need for a prudent funding policy to absorb adverse experience without jeopardizing the plan’s stability.
- A benefit design policy that aims to replace specified percentages of income at retirement needs appropriate funding and investment policies to help stabilize contributions.

**Which Policy Comes First?**

Ideally, the process of setting or adjusting the three policies would begin with the benefit design policy—What benefits does the plan want to provide to participants? In practice, most benefit designs have evolved without a well-thought-out process.

In a perfect world, boards of trustees (or bargaining parties) would begin by designing a plan that best meets the needs of the participants and then develop funding and investment policies to support the benefit design. They would make adjustments among the three policies to ultimately arrive at a benefit design that is affordable and well-coordinated with the funding and investment policies.

**Strategic Approach to Benefit Design**

Despite the wide variety of benefit designs, there are only two distinguishing factors:

- Who has the investment risk—the employer or the participant (or is it shared)?
- How are the benefits allocated among participants?

**Investment Risk**

Conventional wisdom says that in DB plans, the investment risk is borne entirely by the employer, while the invest-
ment risk falls entirely on the participant in defined contribution (DC) plans. In practice, however, both employers and participants share the multiemployer DB plan investment risk: Employers often face contribution increases when investments do not perform as intended, but the shortfall also can be made up by participants allocating a portion of their negotiated wage package to the pension plan. Further, an investment loss may be addressed by reducing participants’ future benefit accruals.

In contrast, the investment risk in DC plans falls squarely on the participants—Employers’ DC plan obligations are limited to the agreed-upon contributions. Investment shortfalls directly impact participants’ ultimate benefits from the DC plan.

Allocation of Benefits

Does the benefit formula favor one group of participants over another? Consider factors such as:

- Age: older vs. younger participants
- Service: longer vs. shorter service
- Pay: higher vs. lower earners.

In general, the pattern of benefit accruals in a DB plan favors older, longer service participants, while DC plans favor younger participants.

Converting from DB to DC will adversely impact midcareer participants the most. Just when the DB accruals are beginning to achieve their greatest financial value, the midcareer participant is switched to a plan type that favors younger participants.

Plans differ in how benefits are allocated among participants. For example, some DB plans provide greater benefits after a specified period of service (e.g., 20 years); others provide greater (or lesser) benefits for compensation above a specified threshold. Still other plans provide significant early retirement benefits, which may provide unintended incentives for participants to retire earlier than their employers would prefer. All of these plan design features can affect participant behavior, in turn affecting the funding risks for the plans. Plan sponsors may not always be aware of the risks inherent in plan design characteristics. A well-thought-out benefit design policy will evaluate the risks associated with the features of the benefit design.

If a plan is revisiting or developing a benefit design policy, it is important to keep the legacy benefit design in mind. With few exceptions, benefits already accrued cannot be reduced, so rethinking a benefit design policy will usually focus on the benefits to be earned in the future. This also raises the issue of intergenerational risk—Younger participants may be saddled with the cost of large accrued benefits earned by an earlier generation. To what extent will the benefits already earned influence the design of benefits going forward?

Characteristics and Risk Profile of Various DB Plan Types

Under ERISA, all retirement plans are legally classified as either a DB or DC plan. However, several hybrid or alternative designs, while legally classified as either DB or DC, exhibit characteristics of the other plan type. The cash balance plan, for example, “looks like” a DC plan but is actually a DB plan.

Here is a brief description of several plan designs and their risk factors. 5

Traditional DB Plan

- Provides a fixed monthly lifetime benefit upon retirement and a continuing lifetime benefit to the participant’s surviving spouse (unless waived).
- Risk factors: Investment, contribution base and PBGC risks all affect participants as well as employers. Benefit adequacy is a key risk for participants (as it is in all plan designs). Longevity risk is typically a much smaller and more manageable risk than the investment and contribution base risks, since mortality improvements, if they do occur, will happen gradually. The degree to which any of these risks impact a particular plan depends heavily on that plan’s funding status—Better funded plans or those plans with prudent funding policies are much better positioned to absorb adverse experience without serious consequences.

Variable DB Plan

- Same as a traditional DB plan except that all or part of the benefit varies based on how plan investments perform relative to an assumed investment return, called the hurdle rate. For example, if the hurdle rate is 5% and the actual return is 7% in a given year, accrued benefits increase by about 2%.
- Risk factors: Variable DB plans shift the investment and funding risk from the plan sponsor to the participants. As a result, variable DB plans often face resis-
tance from unions and participants. The shift in risk to participants can be mitigated by implementing provisions that protect participants, such as (1) a minimum guaranteed benefit, (2) providing a portion of the benefit as a fixed (traditional DB) benefit, (3) making the benefit variable prior to retirement but fixed at retirement or (4) offering a choice at retirement (fixed or variable). A pure variable DB plan essentially eliminates any withdrawal liability with respect to future accruals since benefit liabilities adjust to match the underlying assets, but the withdrawal liability risk attributable to the legacy (prevariable) liability remains. In all other respects, variable DB plans function the same as traditional DB plans, including the payment of PBGC premiums.

The contribution base risk is effectively eliminated, unless the contribution base shrinks so much that operating expenses alone become a financial burden. Unanticipated longevity improvements present a small risk that unfunded liabilities could develop. The risk of higher PBGC premiums remains.

**Cash Balance Plan (DB)**

- A DB plan that defines the benefit as an account balance, similar to the account balance of a DC plan. The account balance increases each year based on “contribution credits” and “investment credits” defined by the plan (these are “notional” credits, not actual contributions and investment returns). Benefits are converted to a lifetime annuity upon retirement or paid as an optional lump sum if offered by the plan. Cash balance DB plans have rarely been implemented in the multi-employer arena, probably because they retain essentially the same investment and funding risks for the plan sponsor as traditional DB plans but appear more like DC plans to the participants. Cash balance plans are subject to the same rules as traditional DB plans, including withdrawal liability and PBGC premiums.

- **Risk factors**: The cash balance plan investment risk can be shifted to the participants by crediting actual or indexed investment returns instead of fixed interest credits, in which case the cash balance plan operates more like a DC plan, though all the DB plan rules would still apply. Unless the investment risk is shifted to the participant, the risks under a cash balance plan are no different from those under a traditional DB plan. Given that cash balance plans typically offer lump-sum distributions to participants, cash balance plan sponsors generally bear less longevity risk than under traditional DB plans, and the sponsor’s investment risk ends at the point of distribution, when both of these risks are transferred to the participant.

**Composite Plan**

- Benefits are determined using a formula like that of a traditional DB plan and are paid as a lifetime annuity. However, the benefit is designed so that contributions are projected to maintain 120% funding. Future benefit accruals may be reduced if necessary to maintain targeted funding levels. Under certain conditions, accrued benefits may be reduced to maintain required funding. Composite plans have not yet been sanctioned by enabling legislation.

- **Risk factors**: If and when composite plans become a reality, they will offer both predictable lifetime retirement income for participants and significantly less funding risk for sponsors than traditional DB plans. The investment and funding risks will be shared between the employers and participants, with participants bearing a relatively greater share of the risk because benefits may be adjusted if necessary to maintain
funding targets. The relatively lower funding risk for plan sponsors follows from the required 120% funding; traditional DB plans typically do not attain 120% funding. However, the 120% funding requirement means that either contributions must be increased to maintain the current benefit accrual or benefit accruals need to be reduced to be supported by current contributions. There may be an increased risk to the legacy plan’s funding because the minimum funding requirements for the legacy plan may be reduced when a composite plan is adopted. If adequate funding cushions for the legacy plan are not maintained, the composite plan may not provide the hoped-for funding stability for the combined legacy/composite plan. Composite plans will have no employer withdrawal liability and no PBGC coverage or premiums.

Benefit Accruals as a Percent of Contributions

Multiemployer DB plans use a variety of formulas to define how benefits accrue. Some plans specify an amount per year of service, some use a percent of pay and others use a percent of contributions. For those plans that define benefits as other than a percent of contributions, it is instructive to convert the monthly benefit formula to a percent of contributions. For example, consider a plan whose monthly benefit accrual is $100 for each 2,000-hour year of service, with a contribution rate of $5 per hour. The benefit, expressed as a percent of contributions, is $100 divided by ($5 times 2,000), or 1%. Benefit accrual rates that reach 3% to 4% (or more) of contributions may not be sustainable because the actuarial cost of benefit accruals might exceed the amount contributed. When this happens, plans must either use accumulated assets to fund future benefit accruals or hope for better-than-assumed investment returns in the future to make up the shortfall between the actual contributions and the cost of benefit accruals—a risky proposition.
Connecting the Benefit Design Policy to the Funding Policy

An effective funding policy will help address the risks associated with the benefit design of a DB plan. The primary purposes of a funding policy are to:

- Guide plan operation
- Stabilize long-term funding
- Determine when benefits can be improved and/or contributions reduced in favorable times
- Determine when future benefit accruals must be reduced and/or contributions increased in unfavorable times.

Funding policies can lessen the chance of funding shortfalls occurring, as well as address shortfalls when and if they occur by establishing and maintaining appropriate funding cushions to absorb adverse experience.

Effective funding policies are developed by using actuarial valuation projections to assess where plan funding may be headed and how sensitive the funding is to variations in experience, particularly with respect to investment returns and work levels.

Funding policies typically specify triggers for change, based on one or more of the most common funding measurements, including the following:

- **Funded percentage**: The value of a plan’s assets as a percentage of its accrued benefit liability. Depending on the purpose for the funded percentage, the assets may be the market value or the “actuarial value,” which “smoothes” gains and losses over a period of time, usually five years. The accrued benefit liability is the present value of the benefits earned by all participants through the measurement date. The funded percentage based on the actuarial value of assets is one of the two funding measurements used in the PPA zone status tests.
- **Credit balance**: A “notional” account (not actual money) that tracks the historical accumulated excess of actual contributions over the minimum required contributions under ERISA. A projection of the credit balance is the other necessary funding measurement for the PPA zone status test.
- **PPA zone status**: Each year, a plan’s actuary must certify the plan’s zone status: critical (red zone), endangered (yellow or orange zone) or neither (green zone). The zone test rules are complex but, in simple terms, a plan’s funded percentage must generally be at least 80% (or projected to be at least 80% within ten years), and its credit balance must be projected to remain pos-

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**FIGURE 3**

**Projected Plan Funding Assuming 6.5% Annual Returns**

<table>
<thead>
<tr>
<th>Plan Year Beginning 1/1</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
<th>2028</th>
<th>2029</th>
<th>2030</th>
<th>2031</th>
<th>2032</th>
<th>2033</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Return During Year</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Credit Balance at 12/31</td>
<td>$350</td>
<td>$404</td>
<td>$456</td>
<td>$500</td>
<td>$532</td>
<td>$531</td>
<td>$497</td>
<td>$443</td>
<td>$410</td>
<td>$336</td>
<td>$272</td>
<td>$211</td>
<td>$148</td>
<td>$64</td>
<td>(84)</td>
<td>(217)</td>
<td>(253)</td>
</tr>
<tr>
<td>Funded Percentage at 1/1</td>
<td>83%</td>
<td>83%</td>
<td>83%</td>
<td>83%</td>
<td>83%</td>
<td>83%</td>
<td>82%</td>
<td>81%</td>
<td>79%</td>
<td>77%</td>
<td>78%</td>
<td>79%</td>
<td>78%</td>
<td>79%</td>
<td>79%</td>
<td>79%</td>
<td>78%</td>
</tr>
</tbody>
</table>

**Source**: Horizon Actuarial Services, LLC.
itive for seven years in order for the plan to be certified in the green zone. If the plan fails either (or both) of the funded percentage and credit balance tests, the plan will be certified in the yellow (or orange) zone. A plan is in the red zone if the credit balance is projected to be negative within four years (or five years, in certain circumstances).

Let’s look at two sample funding policies (simplified for illustration purposes).

Sample Funding Policy 1
- Benefits may be improved only if 100% funding (with the improvement) is projected within seven years.
- Corrective action (contribution increases/benefit reductions) is required if 100% funding is projected to be more than ten years away.

Sample Funding Policy 2
- Benefit improvements are permitted only if the funded percentage (with the improvement) is projected to reach 110% within 15 years.
- Corrective action (increased contributions/reduced benefits) must be taken if the plan is projected to be certified as endangered or critical status within the next five years.7

The funding policy must be clear about whether the board of trustees or the collective bargaining parties have the authority to change benefits and contributions. The more specific the policy is, the less chance of a deadlock in reaching a decision.

The projected funded percentage is arguably the most meaningful measurement to use in a funding policy. If anticipated contributions will cover the actuarial cost of annual benefit accruals (and operating expenses), and also pay down (amortize) a plan’s unfunded liability, the funded percentage will improve over time. Paying down the unfunded liability is analogous to increasing home equity by paying off a mortgage—Since mortgage payments not only cover the interest on the outstanding loan balance but also pay down the principal, the homeowner’s equity increases over time. One goal of a funding policy is to increase the “home equity” of the pension plan. An increasing funded percentage leads to full funding or “ownership” of the plan, securing the benefit promise to plan participants. On the other hand, a declining funded percentage is like a “negative amortization” mortgage, where the mortgage payments don’t cover the interest on the outstanding balances, resulting in decreasing home equity.

These sample funding policies develop funding cushions against possible adverse experience so that changes in benefits and/or contributions are less likely to be necessary at inopportune times, such as during an economic downturn. Further, funding policies formalize a structure for plan sponsors and bargaining parties so that changes in benefits and contributions are made in an objective and orderly manner, with less chance that a benefit improvement or contribution reduction will need subsequent corrective action due to unexpected events.

Evaluating Risk Through Stress Testing
The best way to assess the effectiveness of a funding policy is through stress testing—What happens to plan funding under adverse experience, such as subpar investment returns?

As an example, consider Figures 2 and 3, which show projected funding for a plan under two annual investment return scenarios: 7.5% and 6.5%. This plan’s projected funding appears healthy as long as annual investment

### TABLE I

<table>
<thead>
<tr>
<th>Benefit Liabilities</th>
<th>Less Mature Plan</th>
<th>More Mature Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active</td>
<td>$8,000,000</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Inactive</td>
<td>$2,000,000</td>
<td>$8,000,000</td>
</tr>
<tr>
<td>Total</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Assets</td>
<td>$7,500,000</td>
<td>$7,500,000</td>
</tr>
<tr>
<td>Funded Percent</td>
<td>75%</td>
<td>75%</td>
</tr>
<tr>
<td>15-Year Funding Cost</td>
<td>$774,000</td>
<td>$399,000</td>
</tr>
<tr>
<td>Hours</td>
<td>≈ 200,000</td>
<td>≈ 50,000</td>
</tr>
<tr>
<td>Hourly Cost</td>
<td>$3.87/hour</td>
<td>$7.98/hour</td>
</tr>
</tbody>
</table>

*Assumes both plans have identical benefits.
returns are 7.5% or better. If annual returns are only 6.5%, funding deteriorates, and the plan would need some corrective action.

It is likely unreasonable to base a funding policy on the expectation of an investment loss similar to what plans experienced in the economic crisis of 2008, when the median return was -23.5%. Such a policy would be too conservative, calling for unreasonably high contributions or low benefit levels. But what is a reasonable level of adverse investment experience on which to base a funding policy?

Working with the plan actuary and investment consultant, trustees need to determine what level of adverse experience the plan should be able to tolerate without needing to take corrective action. This requires an understanding of the expected investment volatility under the plan’s investment policy. As noted earlier, a more aggressive investment policy should have a more conservative funding policy (i.e., larger funding cushions) to absorb the greater expected swings in investment returns.

The funding projections illustrated in Figures 2 and 3 are deterministic projections, sometimes called if-then projections. They show what happens if certain underlying assumptions, e.g., investment return, are matched by the experience. Another type of projection, called stochastic projection, determines the likelihood of specified outcomes, such as the probability of becoming 100% funded within ten years or the probability of falling out of the green zone in the next five years. Stochastic modeling can be a very effective tool for quantifying funding risks.

Each plan must determine the appropriate conditions and tests that work for that plan, through careful evaluation of the funding measurements, the risk in the investment policy and the risks associated with the benefit design. The funding policy should be realistic in setting goals and triggers for change.

**PPA “Funding Policies”**

PPA effectively forces plans into statutory funding policies—funding improvement plans (FIPs) for yellow zone plans and rehabilitation plans (RPs) for red zone plans. Plans that must adopt these statutory funding policies still have an opportunity to develop and use FIPs and RPs to more effectively address long-term funding. First, to the extent possible, the FIP or RP should manage risk by building in cushions to lessen the chance that the FIP or RP will need to be updated frequently and to shorten the expected period of funding instability. Second, plans should maintain discipline by saving gains when possible, rather than adjusting the FIP or RP to use up any available margin. Finally, once these plans attain green zone status, they should develop funding policies to achieve the objectives discussed above.

Having an effective funding policy developed by the plan sponsor or bargaining parties can significantly reduce the risk of having to implement a statutory funding policy. Sample Funding Policy 2 is a good example of a policy that stays a few years ahead of the law.

**Derisking**

Much is written and discussed about derisking, which usually means changing the investment policy to decrease expected volatility to help stabilize funding. But derisking the investments too much heightens another risk: the risk of locking in lower returns, thereby increasing long-term

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**TABLE II**

Comparing the Impact of Adverse Hours and Investment Experience on Plan Costs*

<table>
<thead>
<tr>
<th>Benefit Liabilities</th>
<th>Less Mature Plan</th>
<th>More Mature Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active</td>
<td>$ 8,000,000</td>
<td>$ 2,000,000</td>
</tr>
<tr>
<td>Inactive</td>
<td>$ 2,000,000</td>
<td>$ 8,000,000</td>
</tr>
<tr>
<td>Total</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Assets</td>
<td>$ 7,125,000</td>
<td>$ 7,125,000</td>
</tr>
<tr>
<td>Funded Percent</td>
<td>71%</td>
<td>71%</td>
</tr>
<tr>
<td>15-Year Funding Cost</td>
<td>$ 765,000</td>
<td>$ 427,500</td>
</tr>
<tr>
<td>Hours</td>
<td>÷ 180,000</td>
<td>÷ 45,000</td>
</tr>
<tr>
<td>Hourly Cost</td>
<td>$ 4.25/hour</td>
<td>$9.50/hour</td>
</tr>
<tr>
<td>Original Cost</td>
<td>$3.87/hour</td>
<td>$7.98/hour</td>
</tr>
<tr>
<td>Cost Impact</td>
<td>$0.38/hour</td>
<td>$1.52/hour</td>
</tr>
</tbody>
</table>

*Assumes hours are 10% lower and assets are 5% lower.
contribution requirements or lowering benefits. Investment derisking can be expensive because, with lower expected returns, the actuary must lower the valuation interest assumption, which increases the benefit liability and the actuarial cost of future benefit accruals. Investment derisking may reduce the risk of investment return and contribution volatility, but it can increase the risk of higher long-term contributions and/or lower benefits.

Another approach to derisking is to implicitly derisk through the funding policy: Use funding cushions to lessen the risk of needing to reduce benefits or increase contributions without changing the investment policy and sacrificing the upside potential of higher investment rewards.

A Word About Mature Plans

As a plan ages and the number of inactive participants (retirees and vested inactive participants) grows relative to the number of active participants, the plan is said to “mature.” The more mature a plan is, the more sensitive its funding is to investment return and changes in work levels. Thus, the more mature a plan is, the more difficult it is to address funding issues by adjusting benefits and contributions. Tables I and II illustrate how much more expensive a mature plan can be and how much more sensitive a mature plan’s funding is to a change in expected work levels.

Funding policies that work well for less mature plans may not adequately address funding risk for more mature plans. More mature plans need greater funding cushions to absorb experience volatility. Stress testing is especially critical for more mature plans.

Attaining Stability

Appropriate benefit design, funding and investment policies are essential tools to achieve and maintain long-term stability for multiemployer pension plans. Plans with significant legacy funding issues will not achieve this objective overnight, but the sooner steps are taken to coordinate these policies to manage risk, the sooner these plans will be on the path to sustainability. The coordination of these policies can help strengthen the stability of not just each plan, but the multiemployer pension system as a whole.

Endnotes


2. Taft-Hartley multiemployer plans are sponsored by a joint board of trustees, with equal representation of labor and management. Thus, both the employers and participants can be viewed as the “sponsor” of Taft-Hartley plans. Throughout this article, sponsor refers to those actively involved in establishing or updating plan policies.

3. Given that investment policies receive much attention, this article focuses on the other two policies: benefit design policy and funding policy.

4. A severely troubled plan may have little choice but to adopt an aggressive investment policy in an attempt to save the plan. In this case, a less aggressive investment policy may pose a greater risk, if it makes insolvency unavoidable.

5. A comprehensive discussion of alternative retirement plan designs is outside the scope of this article. This is intended to be a brief overview of some of the plan design types available.

6. This is not intended to be a comprehensive description of PPA zone tests. The rules for the zone tests are set forth in Employee Retirement Income Security Act Section 305 and Internal Revenue Code Section 432.

7. Under the Multiemployer Pension Reform Act of 2014, plans can elect to be treated as in the red zone if critical status is projected to occur within five years.