Talking points – New Plan Designs – The Composite Plan

While defined benefit (or DB) plans remain the primary form of benefit for participants in multiemployer plans as they have for more than 70 years, a number of factors have changed the environment for some contributing employers making continued participation in these plans an unacceptable risk.

These factors include both increased market volatility that have produced both real and perceived threats of unfunded liabilities for contributing employers and new financial reporting disclosures for employers that were imposed by the accounting profession which negatively affect employers' ability to access credit markets. This is especially acute in credit dependent industries including, but not limited to construction.

For those employers the only available alternative to continue to provide any retirement benefits under the current tax laws would require adoption of a defined contribution (DC) plan. These plans have their own broadly recognized shortcomings including longevity risk, excessive fees, lack of professional asset management, reduced opportunities to invest in a full range of investment classes and account degradation through various forms of "leakage" (loans, hardship withdrawals, early distributions, etc.). The result is an inefficient system that leaves workers with account balances that are insufficient to meet their lifetime retirement income needs.

These issues were among those addressed by a broad group of stakeholders in the multiemployer community including 42 distinct groups from labor to employers, employer associations, plans and advocates, encompassing virtually the full range of industries in which multiemployer plans are the predominant benefit delivery method. This group met over the course of approximately eighteen months to address the problems of the existing rules and craft recommendations for a new form of retirement plan for the future. Two-thirds of this group's recommendations – those designed to address technical corrections to *The Pension Protection Act* and those designed to provide voluntary tools to preserve plans otherwise destined for insolvency – were enacted in *The Multiemployer Pension Reform Act* of 2014. New plan designs represent the remaining aspect of the group's reform proposals.

The innovative plan design is uniquely suited to the US multiemployer universe, but drew heavily on similar "shared-risk" models found elsewhere. Known variously as a "target" or "composite" plan, the intent was to provide an alternative model that returns to the basic intent of employer sponsored retirement plans: allowing workers in multiemployer plans to receive regular monthly retirement income following a lifetime of service, while removing the disincentives to continued employer participation.

Composite plans are designed as a way of preserving the best of both the DB and DC structures while taking the next step in the seven decade evolution of multiemployer pension plans.

What is a "Composite" Plan?

A composite plan is neither a DB, nor a DC plan, but is a new plan design that draws from the best of both of the existing structures. A DB plan requires that the benefit be "definitely determinable" while a DC plan requires that the benefit be based on an individual account. The composite plan is designed to be a successor to one's traditional DB plan (a so-called "legacy" plan), which would be required to be fully funded in the new structure, but which would cease granting future accruals. The new plan design would resemble that of the current DB structure (typically $X per month per year of service), but would be self-adjusting (as are all DC plans) based on market performance. The attraction of the composite design, however, is that it addresses the recognized shortcomings of the current DC system, allowing more of the contribution and investment returns to be paid out to the participants in their retirement benefit.

Major features of composite plans include the following:

- **Allow participants to maximize their payout by pooling longevity risk.** One of the most appealing aspects of traditional DB plans is that the benefit is paid as a life annuity using the group mortality to determine the payout periods and amounts. Conversely, one of the greatest unknowns for anyone who must decide how much to withdraw from their IRA or 401(k) is how long they will live. In order to ensure that one does not run out of money, most err on the side of taking too little so the money will last. The composite plan addresses this problem by eliminating individual accounts and pooling longevity risk, requiring the benefit to be paid out in a life annuity as it would in a DB plan.

- **Reduce costs by professionally managing investments and negotiating fees.** DB plan assets are typically large enough to permit plan fiduciaries to retain professional investment managers and consultants, access asset classes that are unavailable to the average individual investor, and to negotiate fees that are only a fraction of those charged to the average mutual fund investor. Over one's career, these savings could increase benefits paid out by as much as 25%.

- **Preserve assets for retirement income.** It is often said that participation rates in 401(k) and other DC programs would be significantly lower if workers felt they would be unable to access their funds for other purposes. Nevertheless, one of the factors frequently cited as contributing to low account balances in the current DC system is the problem of "leakage." Leakage occurs when the plan includes features such as loans, hardship and other early distributions that diminish the assets in a retirement account. Composite plans cover all employees pursuant to the applicable bargaining or other written agreement making individual elections unnecessary and prohibit other forms of leakage.

- **Eliminate barriers to both existing and new employer participation.** As these are not DB but modified DC plans, employers make their negotiated contributions as they would under a 401(k) plan, but have no further funding obligations as they would under a DB plan. No unfunded liabilities exist; therefore, no withdrawal liability would have to be reported on employer financial statements.

- **Requires funding at rates sufficient to protect participants against market volatility.** Recognizing that this approach shifts the investment risk to the participants, the rules governing composite plans require contributions at 120% of the projected actuarial cost to fund the benefit. This funding buffer is then evaluated in annual actuarial valuations using a fifteen year projection of assets at market value and the plans' assumed rate of return to determine whether benefit intervention is required.

- **Requires adjustments when annual funding projections drop below 120% to further minimize benefit fluctuations due to market volatility.** DC plan benefits automatically adjust immediately when markets fluctuate. Composite plans moderate adjustments by imposing annual reviews and when projections fall below the 120% target, by imposing a hierarchy of modifications, as needed, to be implemented within a year. Such modifications would begin with the traditional approach of negotiating contribution increases, and/or adjusting benefit accrual rates. More substantial modifications which resemble adjustable benefits under *The Pension Protection Act* and *The Multiemployer Pension Reform Act* are available to return the plan to fiscal health if substantial market corrections occur.