

# Multiemployer Review

Update on issues affecting multiemployer plans

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## COVID-19 to leave multiemployer pension system more distressed than ever

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In March 2020, Milliman published a [Multiemployer Alert](#) about the funding impact that market declines related to COVID-19 have had on multiemployer defined benefit (DB) pension plans. But COVID-19's impact goes beyond the market decline. Many industries are being hit hard by a sudden drop-off in industry activity, with concern that the recovery of normal operation could take several years, reducing the contributions coming into plans. These impacts are a particular concern for mature plans (those with more benefit payments and expenses than contributions), and may have a long-lasting impact on plan funding. Without Congressional action or speedy market recovery, there will be another wave of plan failures. Law makers need to think carefully before providing solutions that further strain an already stressed system.

### The number of significantly troubled plans will likely grow

According to our [December 2019 Multiemployer Pension Funding Study](#), there were 130 pension plans in either critical and declining status or insolvent and paying reduced benefits with financial assistance from the Pension Benefit Guaranty Corporation (PBGC). This recent downturn will likely add more plans to this list if the economy does not bounce back in the near future. Plans have already endured two "once in a lifetime" market events in 20 years and this could be the third. Many plans that will fail in this third event, the COVID-19 pandemic, are plans that fought their way back to better funding through the 2000-2002 dot-com bubble and the 2008 housing and global financial crisis. The tools they used to improve funding were:

- Reducing benefit levels going forward
- Increasing employer contributions
- Reducing early retirement and other benefits for non-retired participants, if in critical status
- Reducing accrued benefits, for all participants including retirees, if in critical and declining status

Even if plans maintained a "green" status through the 2000s and 2010s, many did so via substantial changes to benefit and contribution levels. As a result, plans now provide smaller benefits for larger contributions, because a high percentage of each contribution dollar is being used to improve plan funding and not to provide benefits. It is not uncommon for the benefit accrued per dollar of contribution to be less than half of what was provided for in 2008. This has caused a massive intergenerational transfer of wealth from the active union workforce and its employers to pay off plan underfunding. An analysis of this shift in contributions is found in our [Spring 2017 Multiemployer Pension Funding Study](#).

Entering 2020, the underfunding per active participant was \$28,000. As of April 6, the COVID-19 market downturn has increased this to \$49,000 per active participant.

Without outsized market returns, plans will have to fund this deficit through contributions or face severe funding deficits. \$49,000 is equivalent to \$6,700 per year per active for 10 years using an asset return assumption of 7% and assuming the active population remains constant. This burden will not be borne equally by all plans, so for some plans this be a much bigger funding deficit.

In order to have a functioning system, employers must remain competitive and profitable. Many plans have determined, through work with economists and/or analysis of their industries and geographies, that employers cannot remain competitive if contributions increase further than they already have. A functioning system also needs to be appealing to workers, with a wage and benefits package that is fair and reasonable. Some industries have recently struggled to attract sufficient union workers to meet employer demands. This is sometimes aggravated by a large portion of the wage package being used to improve pension plan funding rather than to provide current pay and benefits.

Because many plans have already pulled the major levers to improve plan funding, pulling these levers harder will not necessarily be economically feasible, resulting in some additional plans becoming critical and declining. The PBGC, which would step in to provide financial assistance, is presently ill-equipped to handle a new batch of struggling plans, as the agency's multiemployer insurance program was projected to run out of assets in fiscal year 2025, even prior to COVID-19, as noted in the PBGC's 2019 fiscal year annual report released in November 2019.

To date, 17 critical and declining plans have received approval from the Treasury to cut accrued benefits to retired and non-retired participants under the Multiemployer Pension Relief Act of 2014 (MPRA). By law, MPRA cuts are designed to just barely solve funding problems, so as to not "over-reduce" benefits. However, these plans have just made their cuts in the past few years and most will not likely be able to sustain this type of market hit without projections looking materially worse. These plans may have to cut benefits further or leave benefits as they are and wait for insolvency, which will involve the PBGC providing financial assistance to pay even lower levels of benefits (i.e., at the PBGC guarantee level).

## Healthier plans take a punch in the gut

It's important to keep in mind that the majority of multiemployer defined benefit plans are generally well funded and not headed for insolvency. As our December 2019 Multiemployer Pension Funding Study noted, 742 out of 1,249 plans were at least 90% funded entering 2020. That's nearly 60% of plans.

Many of these plans pulled the same levers as described above in order to fight their way back to their current funded positions. A large number of these plans have been contributing significantly in excess of the amount to fund benefits and operating expenses in an effort to wipe away underfunding. These "surplus" contributions were not anticipated to be needed indefinitely and many plans were looking forward to the day when they could either:

- Divert these contributions elsewhere (wages, health benefits, annuity funds, etc.)
- Use the surplus to improve what have effectively been tempered benefits, by bringing them up to inflation-adjusted, generationally fair levels

In many cases, plans have not improved benefits for a decade or more, and instead have been providing lower levels of benefits to active members and/or benefit levels that have been well outpaced by inflation.

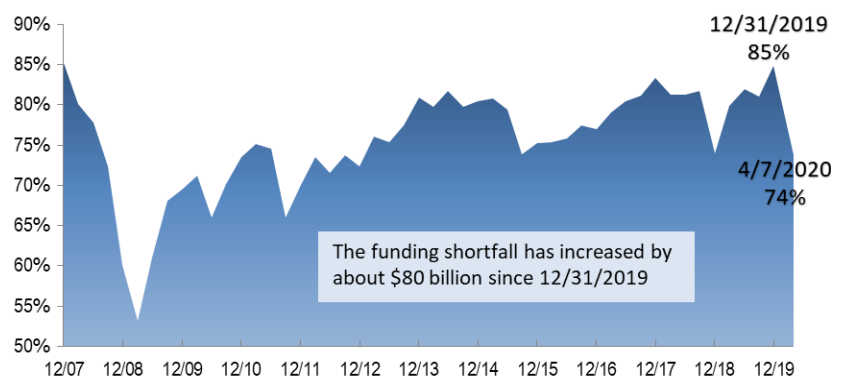
These plans may now need to wait even longer for brighter years ahead. For many plans this could result in an entire generation of workers spending whole careers funding the prior generation's benefits to put the plan on a secure path for future generations, while never enjoying benefits even close to the value of the contributions they have made.

## Decline in funded status

As shown in Figure 1, the multiemployer system's aggregate funding level is estimated to have dropped from 85% to 74% between January 1 and April 7, 2020, undoing a significant portion of the last 10 years of funding improvement. This drop corresponds to an \$80 billion increase in the system's underfunding. See our March 2020 Multiemployer Alert for more on this topic.

Without future excess returns above the asset return assumption, which on average is about 7.1% across the system, the year-to-date decline in funded status amounts to an additional \$21,000 dollars of underfunding per active participant, based on the number of actives in our last Multiemployer Pension Funding Study.

FIGURE 1: MULTIEMPLOYER AGGREGATE FUNDING LEVELS, 2007-2020



## Contributions matter

The funding improvement we have seen over the past 10 years has not only been the result of good market returns, it has also been due to increased contributions.

Contributions will be lower in 2020 and perhaps for some years beyond 2020 as markets recover from COVID-19. Right now as people are sheltering in place across the globe, spending has slowed. Janet Yellen, in an interview with CNBC on April 6, called this a “dramatic decline in economic activity” and estimated that, on an annualized basis, the gross domestic product (GDP) would decline 30% in the second quarter of 2020. She is not optimistic that recovery will have a V shape, but thinks recovery could be much slower and that the U.S. unemployment rate is likely 12% to 13% and rising.

Contributions to multiemployer pension plans may remain lower for some time, as social distancing may continue for several months, with the possibility of multiple waves of infection leading to multiple economic disruptions. This will reduce the hours worked in industries deemed nonessential, and will also slow work after social distancing stops due to supply chain interruptions that in turn are due to high demand or local distancing orders occurring in other parts of the world where raw materials, components, supplies, or tools are obtained.

The industries hardest hit by the economic slowdown include some in the multiemployer sector. According to the U.S. Bureau of Labor Statistics, they include restaurants, hotels, travel, entertainment, retail, manufacturing (including the auto industry), transportation, and warehousing. Some industries, such as nonessential retail and restaurant work, have ground to a halt.

Anecdotal indications for some construction work is that there may be as much as a 30% slowdown in work in the near term. The rate of recovery will depend on social distancing protocols over time as well as the amount that state and federal governments will commit to infrastructure after having just made large spends for COVID-19 efforts. For these reasons, it is possible that recovery of regular activity could take a number of years. Some of the more vulnerable employers may not survive, which could reduce the future levels of contributions into plans.

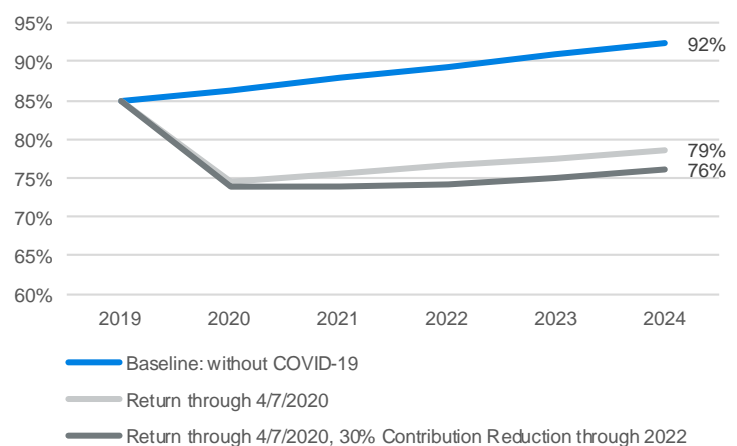
In the most recent year available, reported annual contributions to the system were around \$33 billion. If the aggregate number of hours worked in the system declines by 30% for 2020, contributions would decline by nearly \$10 billion. To the extent the slowdown lasts longer than a year, this reduction in funding will accumulate. If the 30% decline lasted three years, it could cause a reduction of \$30 billion in assets by December 2022. This reduction in contributions may have a corresponding decrease in the benefits earned in the plans of about \$15 billion,<sup>1</sup> resulting in a net increase in the system’s funding shortfall of about \$15 billion.

When combined with the current \$80 billion increase on the funding shortfall due to the recent market decline, the total COVID-19 impact could be \$95 billion, with about 15% of the impact coming from lost contributions and 85% coming from the market decline. If this total impact is spread over a 30% smaller workforce, this represents \$35,000 of additional underfunding per active employee.

Figure 2 shows the system’s projected funded percentage at the end of each year for the next five years. The baseline ignores 2020 activity to date, and is compared first to projections based on the recent market event, followed by expected returns thereafter, and second showing the market decline coupled with a 30% reduction in hours for three years. This illustrates the dramatic impact investment returns have, but also highlights how contribution declines can further slow funding progress. The longer a downturn goes on, the bigger the impact will be.

Obviously, the severity and duration of COVID-19’s impact on financial markets and industry activity are difficult to predict. This example is one possibility and reality could turn out to be better or worse than this. What is clear is that, without a near-term recovery or other intervention, this decline will likely result in more plans in critical and declining status.

**FIGURE 2: IMPACT OF COVID-19 ON FUNDING PROJECTIONS.**



<sup>1</sup> We have assumed that the normal cost (the value of benefits accruing) is proportionate to contributions for all plans. However, for some plans, the normal cost is not particularly sensitive to hours, such as plans with a low hours threshold for a flat accrual. For these plans, a drop in hours may not change the benefit earned, so their funding shortfalls may increase more than other plans.

A contribution decline is worse for mature plans because of negative cash flows. This means that benefit payments and expenses are larger than contributions and so assets must be sold each month in order to make the promised benefit payments. Right now, the assets that are being sold are at very low prices and must be sold before the market value can recover. Further, because contributions are smaller, the plan has to sell more assets than usual. By comparison, in a plan with positive cash flow, contributions each month are sufficient to pay for benefits and expenses. Any excess assets are then added to the pool of assets that are invested when the recovery comes and assets need not be sold at their low points.

A contribution decline is also worse for plans that are in endangered and critical statuses. These plans already have a substantial portion of their contributions paying down their funding shortfalls. When hours are lower, funding progress is harder hit. Figure 2 shows a 3% funded percentage impact on the system due to a downturn where hours are down 30% for three years. For green plans this impact is less than 2%. For endangered and critical plans, the impact is 3.5%-4% and moves more of these plans onto a downward path.

## Potential demographic changes

There may be some near-term or long-term changes as a result of COVID-19. It is possible that we will see a change in participant retirement behavior or in expected mortality experience. These changes could result in gains or losses to the plan beyond those discussed above.

Following the 2008 global financial crisis, many pension plans experienced lower numbers of voluntary retirements in the immediately following years, as employees felt a need to maintain income and allow time for personal savings to recover. While it's possible this COVID-19 crisis will result in similar experience for some, that won't be true in all cases. First, what is voluntary and involuntary retirement this time around may be quite different. Some industries will not have the ability to provide steady work for the same number of participants. Second, given the health-focused aspects of this crisis, coupled with social distancing and the effect that has had on people's lives and daily habits, it is possible this event spurs an acceleration of retirements for some individuals who decide to limit their exposures, particularly if this crisis were to become seasonal.

In addition to changes in retirement behavior, disability claims tend to rise when there is less available work. While the incidence of disability is generally quite low, it can be a valuable benefit to participants. Many plans have reduced or eliminated disability benefits since 2008, so while the incidence of disability is expected to rise, the cost to the plans may be less than it would have been prior to the market declines of the 2000s.

It is worth noting the possibility that retiree mortality experience may spike as a result of this crisis. As just about every study has noted, those most prone to the dangers of this virus are the elderly and those with underlying health conditions. It is not uncommon for a pension plan to have 10% to 15% of its liability associated with retirees over the age of 75. A short term 1% increase in mortality for that group would reduce pension liabilities by well less than half a percentage point. This will not have a material impact on plan funding. 1% is used here as an illustration. The actual impact on a given pension plan would depend on the infection rate and accompanying death rates, but it is clear that it would take much more than a 1% increase in this group's mortality for there to be a material impact on the plan.

While it is way too early to tell what lasting effects might take hold with participant behavior or plan experience, it is something that businesses, organizations, and plans should be thinking about.

## Path forward

There are over 10 million American workers who rely on the multiemployer DB system. Without additional tools or funding from outside the system, many plans may not be able to survive the stress imparted by COVID-19's impact on the markets and levels of industry activity. For many plans, the levers currently available have already been pulled as far as economically feasible. Pulling those levers further may have unintended consequences, such as increasing bankruptcies, and eroding participants' confidence in the system. In addition, efforts to address the PBGC's projected shortfall through premium increases alone could have unintended consequences, such as exacerbating underfunding. Back in March 2016, prior to COVID-19 events, the PBGC's [Five Year Report for Multiemployer Plans](#) estimated that it would take premium increases of 6 to 8 times then current levels to have a high degree of certainty in meeting anticipated obligations for the multiemployer system. It is possible that COVID-19 will result in an even worse outlook for the multiemployer system's backstop. Increases of this magnitude or more could significantly depress the cash flow situation for plans in these challenging times, adding further stress to already struggling plans and resulting in otherwise "healthy" plans becoming "unhealthy" plans.

It may be time to look for plan designs that are more robust against market volatility, regardless of maturity. Consideration should be given to new benefit structures that do not get underfunded due to investment returns, such as variable plans or some types of modified variable plans. This will not fix past funding issues, but will secure future benefits to avoid funding problems in future market events and mitigate intergenerational transfer of wealth.

## For more information

For more information on the impact of the recent downturn on your plan, or what a sustained decline in industry activity might mean, please contact your Milliman consultant. To see Milliman's library of COVID-19 publications, go to <https://us.milliman.com/en/Health/Coronavirus-COVID-19>.

## About this study

The numerical results in this study were derived from publicly available Internal Revenue Service (IRS) Form 5500 data as of December 2019 for all multiemployer plans, the compilation of which is outlined in our December 2019 Multiemployer Pension Funding Study dated February 24, 2020. Significant changes to the data and assumptions used in aggregating these results could lead to different results for individual plans, but would likely not have a significant impact on the aggregate results or the conclusions in this study.



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