AFL-CIO Retirement
Security Working Group

PBGC Guidance on Special Financial Assistance Program

Virtual Briefing: July 29, 2021

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This presentation was prepared by Segal at the request of the AFL-CIO Retirement Security Working Group. It is not complete without the commentary by Segal at the July 29, 2021 virtual briefing.

Segal

Introductory Remarks

PBGC interim final rule on Special Financial Assistance program, published July 9, 2021

Overview and Commentary

Special Financial Assistance (SFA) program

- Section 9704 of American Rescue Plan Act of 2021 (ARPA)
- PBGC provides lump sum financial assistance to eligible multiemployer plans

Better than we would have expected in 2020

- PBGC estimates SFA program cost to be $94 billion
- Significantly more relief than under Joint Select Committee proposal from 2018
- Likely better than bipartisan compromise almost reached in December 2020
- Does not include funding reforms (some earlier proposals were draconian)
- Plans that receive SFA not required to reduce benefits

Not a permanent solution

- Most plans that receive SFA will still be projected to become insolvent
- PBGC's multiemployer insurance program still projected to become insolvent
  - CBO report from February 17, 2021 estimates PBGC insolvency in mid-2040s

The expectation of many was that the American Rescue Plan Act would restore solvency to all troubled multiemployer plans.

PBGC Guidance on SFA Program

Where does the Interim Final Rule fall short?

SFA will delay insolvency only to 2051 (or sooner)

- Many plans that receive SFA will become insolvent several years before 2051
- Due to gap between interest rate assumption and restrictions on SFA assets

Many eligible plans will receive zero in SFA

- Applies to plans in critical (not declining) status with no projected insolvency in 30 years
- PBGC acknowledged this point in its July 9, 2021 webinar

MPRA plans face a dilemma

- "MPRA plans" are those that suspended (reduced) benefits under MPRA to remain solvent
- Projected to remain solvent indefinitely with suspensions intact
- If receive SFA, must restore suspended benefits, but SFA may not provide solvency
- Possible fiduciary challenge for plan trustees

PBGC interim final rule (IFR)

- Published on July 9, 2021
- Comment period open through August 11, 2021

Further Discussion

PBGC interim final rule on Special Financial Assistance program, published July 9, 2021

Key Provisions

PBGC interim final rule on Special Financial Assistance (SFA)

Topic	Commentary
Eligibility Criteria	• PBGC added flexibility plans in critical (not declining) status to show eligibility • But many eligible plans will receive zero in SFA
Amount of SFA	• PBGC went with "low end" approach • Eligible plans will receive only enough SFA to cover benefits through 2051
Interest Rate Assumption	• Significant gap between interest assumption and restrictions on SFA assets • Most eligible plans will use interest rate of about 5.5% to determine SFA • SFA assets must be invested in bonds yielding 2% to 3% • As a result, many plans will likely become insolvent several years before 2051
Investment Issues	• No significant restrictions on investment of non-SFA assets • PBGC seeks input on investments, goal of providing further guidance
Priority Groups	• PBGC spaces out priority applications through 2021 and 2022 • Plans without priority status will likely have to wait until 2023 to apply
Withdrawal Liability	• No provision to disregard SFA assets in determining withdrawal liability • Plans must use PBGC mass withdrawal interest rates for at least 10 years

Positive Takeaways

PBGC interim final rule on Special Financial Assistance (SFA)

Future contribution increases disregarded

- Amount of SFA includes only contribution rate increases already adopted in CBAs
- No requirement to include future rate increases under a rehabilitation plan

PBGC could have imposed more restrictions

- Flexibility on future accrual rate increases (past service increases prohibited)
- Opportunities for plans to reduce contribution rates (may need PBGC approval)

Investment guidance

- PBGC defers to plan fiduciaries to determine what assets are “investment grade”
- PBGC seeks further input on plan investments for possible future guidance
- Might PBGC provide additional flexibility on investment of SFA assets?

PBGC guidance is an “interim final rule”

- Eligible plans may rely on guidance now when submitting applications
- Comment period open through August 11, 2021
- Might PBGC show flexibility on some of its key interpretations?
- Conceivable that there will be no “final-final” regulations

Eligibility

Criteria		Est. Number of Plans
1. Critical and declining	In critical and declining status in any plan year beginning in 2020, 2021, or 2022	~ 110
2. Suspension approved	Suspension of benefits under MPRA approved as of APRA enactment (March 11, 2021)	18
3. Critical status and other criteria	In critical status in any plan year beginning in 2020, 2021, 2022, *and* - Current liability funded percentage < 40%; - Ratio of active to inactive participants < 2 to 3 *Not all tests must be met in the same plan year; does not apply to plans electing early critical status*	~ 100
4. Insolvent after MPRA	Plan that became insolvent after passage of MPRA (December 16, 2014), has not terminated	~ 20

Notes

- PBGC estimates more than 200 plans will be *eligible* for SFA
- In July 9, 2021 webinar, PBGC noted that some eligible plan will receive *zero* SFA

Amount of Special Financial Assistance

Statutory language

"The amount of financial assistance … shall be such amount required for the plan to pay all benefits due during the period beginning on the date of payment of the special financial assistance payment under this section and ending on the last day of the plan year ending in 2051, with no reduction in a participant's or beneficiary's accrued benefit…"

Interpretations of Amount of Special Financial Assistance (SFA)

Low-End	High-End	Middle Ground
(1) SFA enables plan to pay benefits and expenses only through 2051	(2) SFA is equal to present value of benefits and expenses through 2051 regardless of plan's solvency needs	(3) SFA enables plan solvency through 2051 and beyond

PBGC interim final rule

- PBGC regulations prescribe "low-end" approach for calculating SFA
- Methodology determines SFA to cover benefits and expenses through 2051
- Calculation considers all available plan resources (assets, future contributions)

Interest Rate Assumption

Statutory definition

- In general, use plan's interest rate from 2020 zone status certification
- Interest rate subject to upper limit of third PPA segment rate plus 200 basis points
- Most eligible plans are limited to an interest rate of about 5.5%

Major internal inconsistency

- Statute requires SFA assets to be invested in investment-grade bonds

  … Or other investments permitted by PBGC through regulation
- Current yields on investment grade bonds are around 2% to 3%
- Many eligible plans cannot reasonably attain 5.5% benchmark return on total plan assets
- If plans fall short of benchmark return, they will become insolvent before 2051

"Bifurcated" interest assumption

- Recommended by several commenters to PBGC
- Use bond yields to project SFA assets, plan's limited interest rate for non-SFA assets
- PBGC rejected this approach in its interim final rule

PBGC Commentary

Excerpts from preamble to interim final rule

On the overall scope of the SFA program

"While not a permanent solution, Congress enacted, and the President signed into law…, the American Rescue Plan Act of 2021…, to address the immediate crisis facing severely underfunded multiemployer plans and the solvency of PBGC, and to assist plans by providing funds to reinstate suspended benefits.

"To the extent that a plan has other means available to pay benefits, it does not require or need SFA for that purpose. Thus, **all of a plan's resources must be considered** in determining the amount of SFA for the plan."

"… PBGC has concluded that the [alternate] approaches recommended in these comments **could be supported only by a strained reading** of the clear language of section 4262(j)(1)..."

On calculating the amount of SFA

"PBGC believes that the **plain meaning of the statutory language** is that SFA is the amount by which a plan's resources fall short of its obligations, taking all plan resources and obligations into account."

"If Congress had contemplated the exclusion of these resources in the calculation of the amount of SFA 'required for the plan,' **it would have done so explicitly**."

"Under section 4262(e)(4), if a plan determines that use of one or more prior assumptions is unreasonable, the plan may propose to change such assumption. This provision specifically states that **the plan may not propose a change to the interest rate** required for eligibility or SFA amount. In addition, **PBGC does not have authority** to provide a different rate or bifurcate the statutorily mandated interest rate."

On the interest rate assumption

Investment Issues

Restrictions on SFA assets

- PBGC provides guidance “investment grade” assets
- Guidance largely defers to plan fiduciaries

Restrictions on overall asset allocation

- Plans must maintain minimum allocation to investment grade assets
- Minimum allocation is one year of benefit payments plus administrative expenses

PBGC seeking input on investments

- Goal to find “balance” between security and flexibility
- Comments due by August 11, 2021
- Will PBGC permit SFA assets to be invested in non-investment grade assets?

If PBGC gives trustees more flexibility in investing SFA assets – but does not increase the amount of SFA – trustees may take on more investment risk to try to extend plan solvency.

Comparison of Two Plans: A Case Study

Two hypothetical plans

- Both plans in critical and declining status
- Both plans have same benefits and actuarial liabilities
- Plans differ in current asset values and future contributions
- In both regards, Plan A is weaker than Plan B

Assumptions

- Both plans have been de-risking investments
- Both plans have actuarial interest rate of 5.5%
- Limited interest rate for SFA calculations is also 5.5%
- SFA assets are invested in bonds returning 2.5% per year

Scenarios

- Status quo – plans receive no SFA
- Plans receive SFA based on PBGC interim final rule
- Plans receive SFA based on "bifurcated interest rate"
- Plans receive "high-end" SFA (present value of benefits and expenses through 2051)

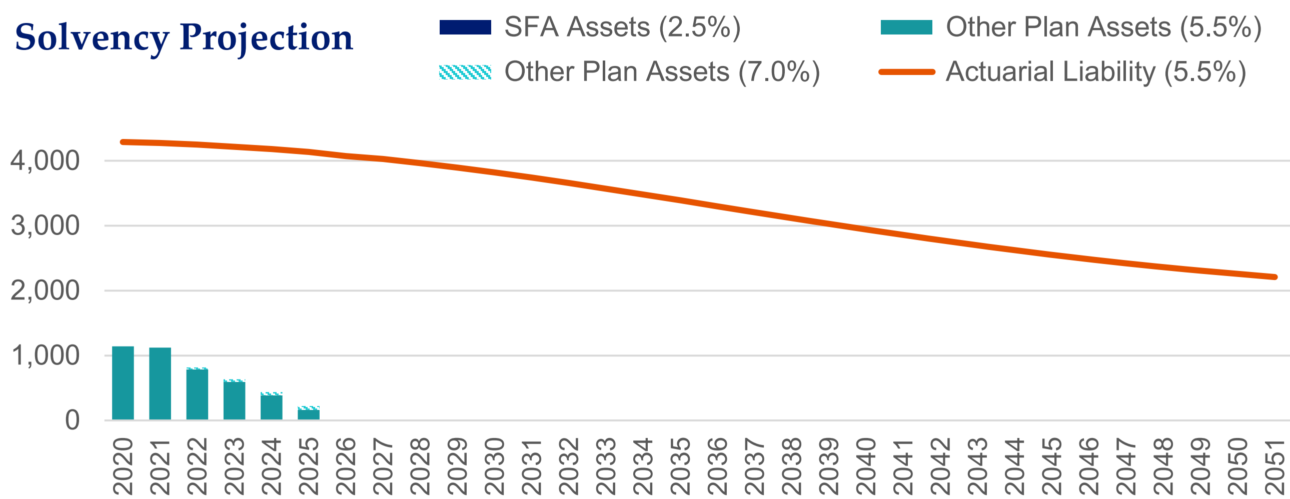
For simplicity, examples assume the plans will receive SFA at end of 2021; in reality, they may not receive SFA until 2023.

Comparison of Two Plans: Status Quo

Generalized illustrations; results will vary by plan and assumptions

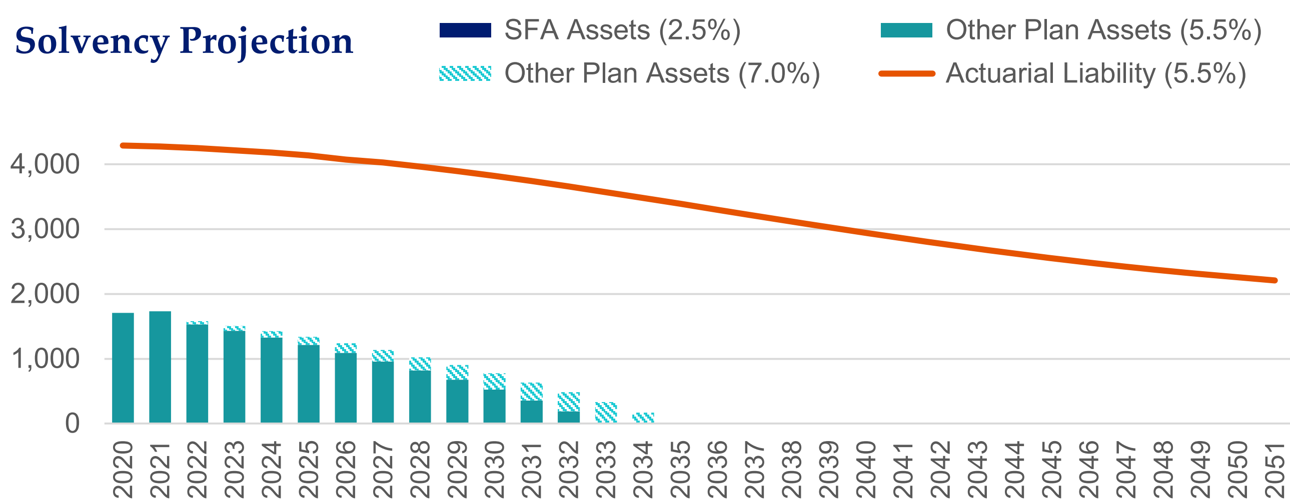
Plan A

- Insolvent in 2026 without assistance
- Assumes plan assets return 5.5%
- If plan assets return 7.0%, solvency extended by less than 1 year



Plan B

- Insolvent in 2033 without assistance
- Assumes plan assets return 5.5%
- If plan assets return 7.0%, solvency extended into 2035



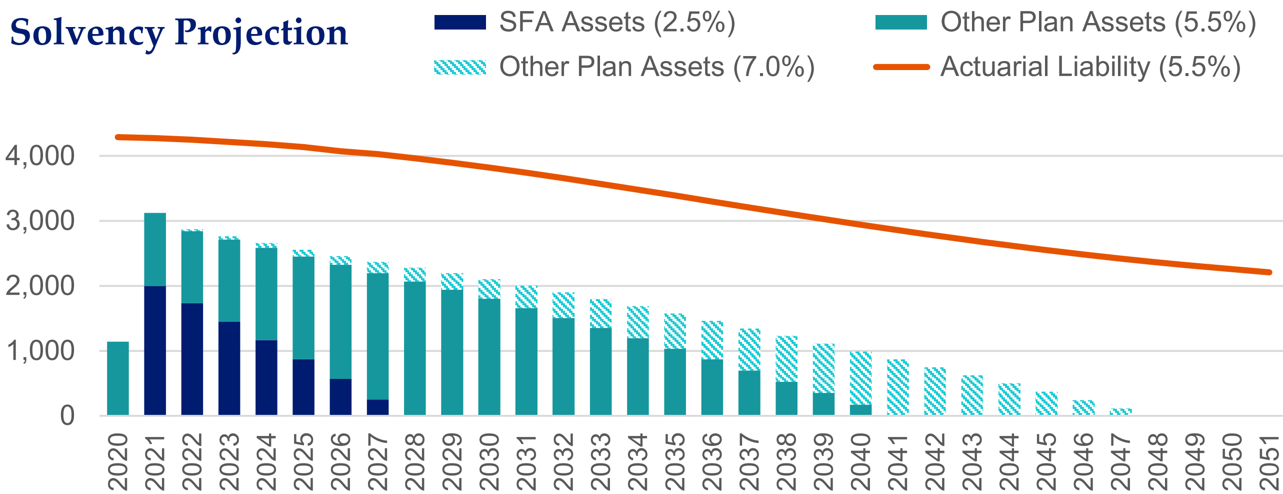
Examples assume plan exhausts all SFA assets before paying benefits and expenses from non-SFA assets

Comparison of Two Plans: Impact of SFA

Generalized illustrations; results will vary by plan and assumptions

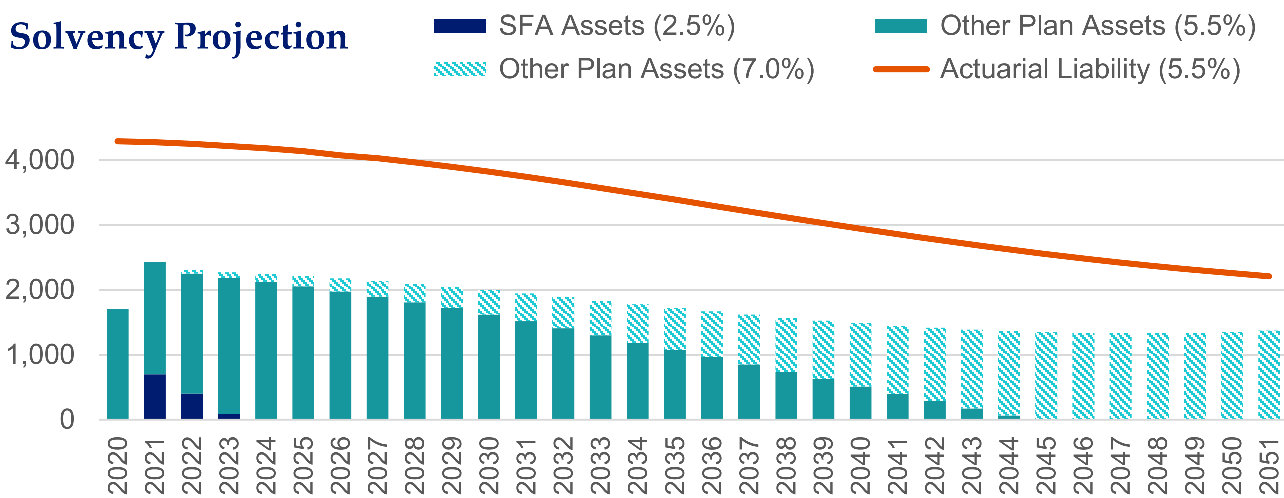
Plan A

- Receives **$2,000** in SFA
- Amount of SFA based on 5.5% single interest rate
- If SFA assets return 2.5%, other plan assets return 5.5%, insolvent in 2041
- If other plan assets return 7.0%, insolvent in 2048



Plan B

- Receives **$700** in SFA
- Amount of SFA based on 5.5% single interest rate
- If SFA assets return 2.5%, other plan assets return 5.5%, insolvent in 2045
- If other plan assets return 7.0%, solvent indefinitely



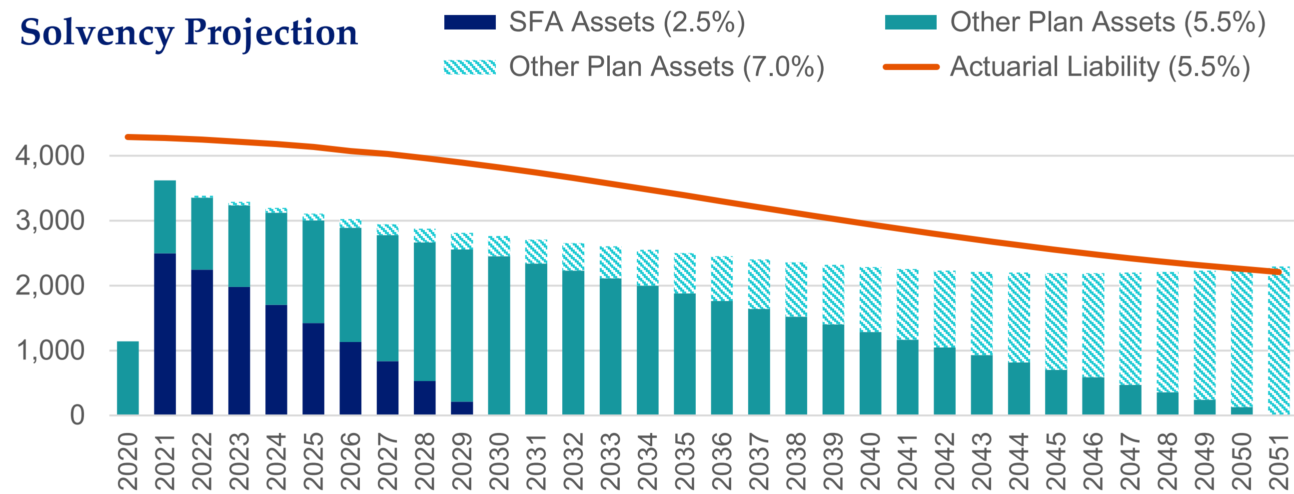
Examples assume plan exhausts all SFA assets before paying benefits and expenses from non-SFA assets

Comparison of Two Plans: Bifurcated Interest

Generalized illustrations; results will vary by plan and assumptions

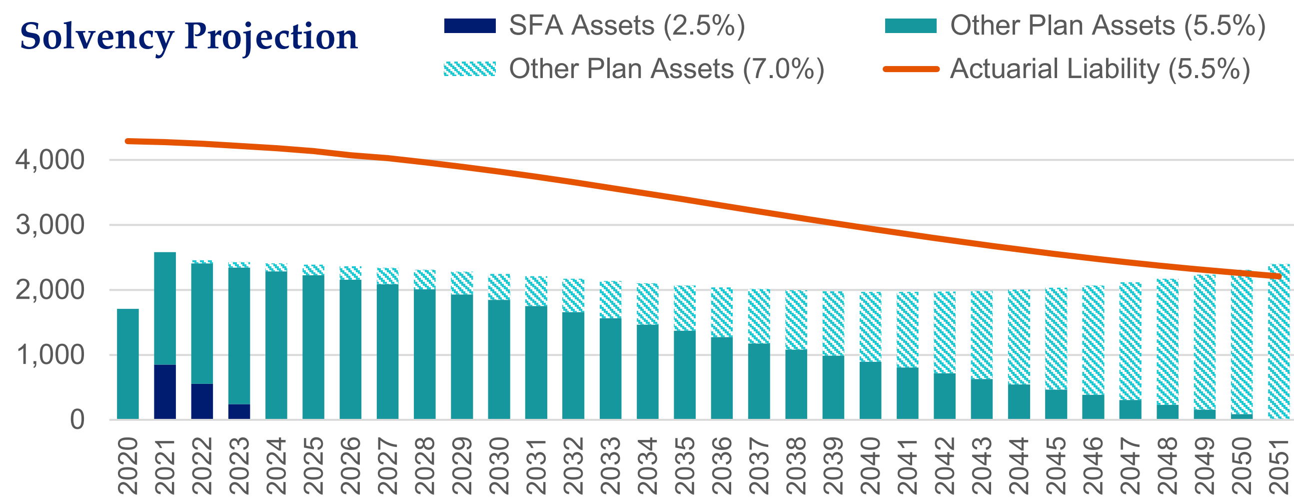
Plan A

- Receives **$2,500** in SFA
- Amount based on bifurcated interest (2.5%, 5.5%)
- Assuming same asset returns, insolvent in 2051
- If other plan assets return 7.0%, solvent indefinitely, approach 100% funding



Plan B

- Receives **$850** in SFA
- Amount based on bifurcated interest (2.5%, 5.5%)
- Assuming same asset returns, insolvent in 2051
- If other plan assets return 7.0%, solvent indefinitely, approach 100% funding



Examples assume plan exhausts all SFA assets before paying benefits and expenses from non-SFA assets

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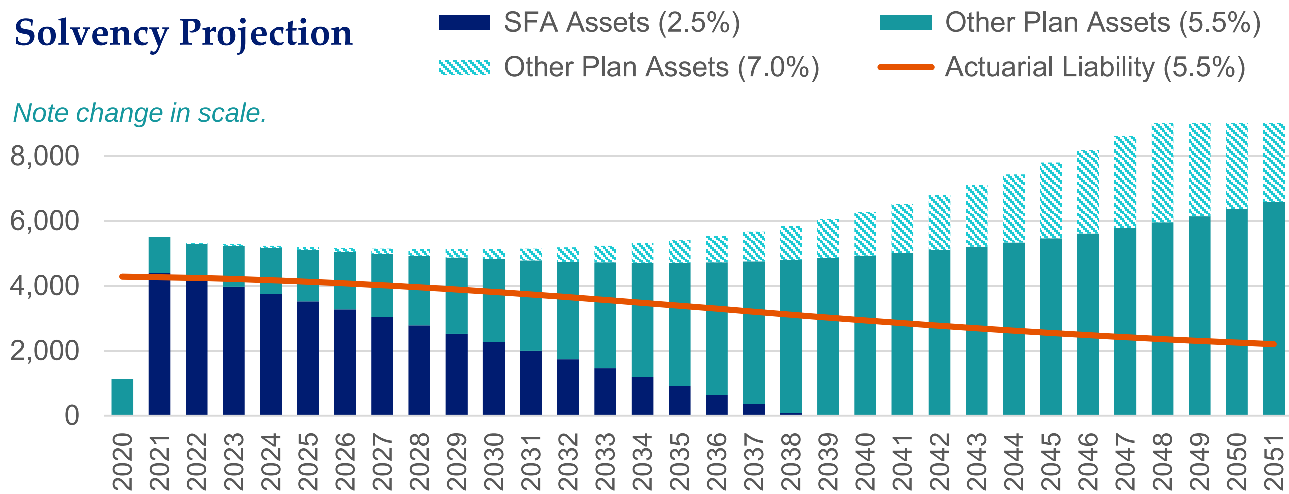
Comparison of Two Plans: High-End Approach

Generalized illustrations; results will vary by plan and assumptions

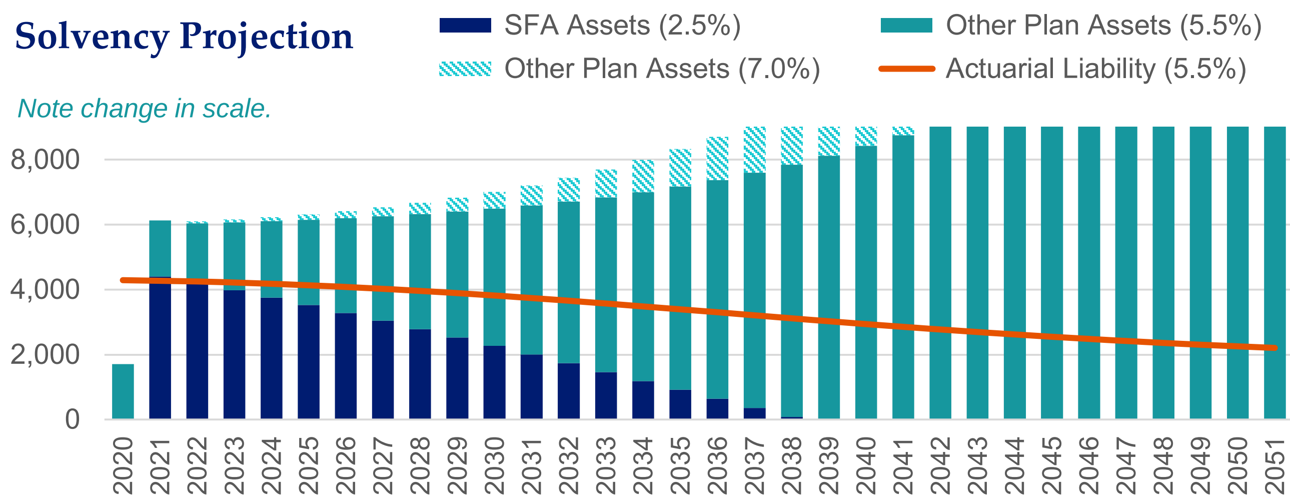
Plan A

- Receives **$4,400** in SFA
- Amount represents present value of benefits and expenses through 2051, at 5.5% interest rate
- Plan is likely to be significantly over-funded



Plan B

- Receives **$4,400** in SFA
- Amount represents present value of benefits and expenses through 2051, at 5.5% interest rate
- Plan is likely to be significantly over-funded



Examples assume plan exhausts all SFA assets before paying benefits and expenses from non-SFA assets

Priority Groups

Priority Group		Earliest Application Date	Est. Number of Plans
1	Already insolvent, or projected to be insolvent by March 11, 2022	Immediately	25
2	Implemented a MPRA suspension as of March 11, 2021; or Expected to be insolvent within one year of their application	January 1, 2022	18
3	In critical and declining status with more than 350,000 participants	April 1, 2022	1
4	Projected to become insolvent by March 11, 2023	July 1, 2022	3
5	Projected to become insolvent by March 11, 2026	TBD; no later than February 11, 2023	22
6	PBGC calculates the present value of financial assistance (if plan becomes insolvent) to be in excess of $1 billion	TBD; no later than February 11, 2023	11

These counts do not include over 100 eligible plans that do not have priority.

Notes

- The estimated number of plans was reported by PBGC on its July 9, 2021 webinar
- PBGC may add additional priority classes based on other circumstances similar to those described in the first 6 priority classes and will post dates when those plans may apply on its website

Thank You

Further Discussion