

SEI RESEARCH:

## Four Key Issues Impacting Multiemployer Pension Trustees in 2010

The **Pension Management Research Panel** recently conducted research to identify the most pressing issues facing multiemployer pension plan trustees in today's environment. The panel conducted primary research by questioning representatives from 31 different multiemployer pension funds. Of those individuals questioned, 39 percent were union trustees and 19 percent were management trustees while the remaining 42 percent fill other pension administrative roles. None of those questioned were clients of SEI. The paper below identifies four of the biggest challenges facing multiemployer plans, while outlining how they are being addressed:

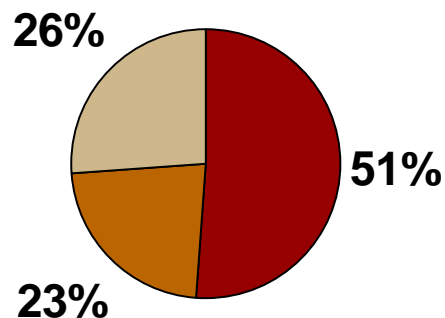
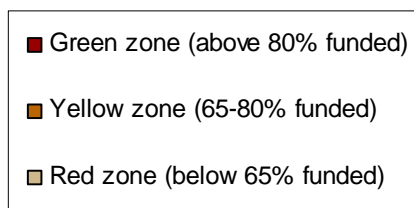
### 1. Poor Funded Status for Many Multiemployer Plans

The Pension Protection Act (PPA) of 2006 strongly incented trustees to monitor their plan's projected funded status to avoid being labeled "yellow zone (generally between 65 to 80 percent funded)" or "red zone (generally less than 65 percent funded)." Placement in one of these categories could result in significant restrictions on the pension, requiring the creation of a plan to improve funded status and new disclosures to members.

The funded status of most multiemployer defined benefit plans in the U.S. has dropped significantly. In fact, **nearly half (49 percent) of the multiemployer plans questioned for this research said their plan was either in the "yellow zone" or, worse yet, the "red zone."**

Following the market downturn of late 2008 the Worker, Retiree, and Employer Recovery Act (WRERA) provided multiemployer trustees with a permissible election to treat the plan's current status as the plan's status in the preceding plan year. As a result, **nearly three quarters (73 percent) of the plans polled took advantage of this option and elected to freeze the fund's zone status at the 2008 level for 2009.**

#### Funded Status of Multiemployer Plans Polled



## 2. Managing Funded Status Volatility Moving Forward

While WRERA provided short-term relief, the long-term challenge of managing these funding deficiencies remains an issue for multiemployer trustees. A 2009 study from Moody's Investors Service estimates a long-term deficit of the country's multiemployer pension plans of approximately \$165 billion<sup>1</sup>. This has prompted Congress to recently discuss potential additional relief measures.

Historically, funding deficiencies were not a significant challenge for multiemployer plans as they built large credit balances (to serve as a cushion on the minimum funding requirements) and even dealt with deduction issues.

The emphasis of the PPA on funding deficiencies resulted in trustees increasing focus on the long-term status of the plan. The recent market volatility has further emphasized that need as **two thirds (67 percent) of those surveyed said that managing funded status volatility has become a significant challenge.**

As a result, multiemployer trustees have turned their attention to aligning the plan's liabilities with the plan's assets. **Two thirds (67 percent) of those polled said the trustees are focused more on the plan's liabilities when setting their investment strategies.** This means that multiemployer plan trustees will continue to move away from the traditional asset allocation and investment models to newer models focused on asset management designed to improve or protect the plan's funded status.

## 3. How Much and Where to Invest in Alternatives

Historically, multiemployer plans had been relatively conservative when it comes to investing in alternatives; however, as part of a transition towards new investment management models the use of these products has increased. As trustees determine the best strategies for improving the plan's funded status, alternative investments have become an attractive option for helping to limit investment volatility, while also providing significant returns in a manner less directly connected to traditional capital market performance.

A significant majority **(87 percent) of the multiemployer plans polled are currently investing in alternatives.** And more than **one third (39 percent) of those plans questioned said that the organization has increased their plan's allocation in alternatives over the past 12 months.**

While most plans use alternatives, there is a variation in the amount allocated to them. Of those polled, the **highest allocation to alternative investments was 31.5 percent, while more than half (61 percent) allocate 15 percent or less.**

The most popular alternatives currently being used by poll participants are **real estate (84 percent), hedge funds (48 percent) and private equity (42 percent).**

With increased attention to the plan's current funded status and the recent drops in that funded status, trustees must find ways to increase investment diversification in an effort to address the volatility of the assets and the plan impacts that follow. Alternative investments are clearly being

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<sup>1</sup> "Growing Multiemployer Pension Funding Shortfall is an Increasing Credit Concern" (Moody's Investor Service) Published Sep 10, 2009

used as one strategy to achieve those goals, but there is less consistency on how much to use them or which alternative asset classes are the best option.

#### 4. Scrutiny of Investment Process

As multiemployer trustees are being challenged with funding volatility they must also deal with the increased scrutiny that has come with it. **Nearly half (47 percent) of those polled said the plan participants are concerned about the long-term viability of this benefit.**

Trustees of these plans understand this concern, which leads them to focus on protecting this benefit for the members and to further evaluate the overall investment model. **While nearly all of those polled (84 percent) said the trustees use a consultant who provides a selection of manager finalists, it is ultimately the trustees who select managers and make manager changes. Nearly a quarter of that group (23 percent) said the trustees would like to reduce the time spent evaluating and selecting manager finalists from the consultants.**

With increased attention on the plan's current funded status and the adoption of new, non-traditional investment strategies, the trend towards considering different investment models should continue. **Almost three-quarters (73 percent) of those trustees using a consultant said it has been more than five years since they last changed their consultant or advisor.**

#### Conclusion

It's clear there are real challenges facing multiemployer plans, the greatest of which relates directly to funded status volatility. The themes of managing funded status volatility and managing pension assets in line with pension liabilities weigh heavily on the minds of trustees.

As investment strategies within multiemployer plans shift from the traditional returns-only success metric to a metric more in line with funded status, other changes should also be expected. There appears to be a trend towards alternative investments and the consideration of liability driven strategies.

Trustees are looking to protect the long-term prosperity of the plan and are trying to find ways to leverage their time on strategic initiatives that are aligned with that. They are looking to design asset allocation strategies that integrate and align numerous components of the plan - such as contribution requirements, future contribution expectations, credit balance and overall liabilities. New asset classes are being added to the portfolio and some trustees are concerned current models already require too much time for selecting investment managers. As a result, investment management models that have gone years without changes are currently under evaluation.

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