HYBRID WITHDRAWAL METHOD AND ALTERNATIVE PLAN DESIGN STRUCTURE

Prepared by:
BEYER-BARBER COMPANY

PART I

CURRENT WITHDRAWAL LIABILITY METHOD

CURRENT METHODOLOGY

- The current method for allocating and assessing withdrawal liability for most plans is called the “Presumptive Method” or the “20 Pool Method”.

- For each plan year, the portion of Unfunded Vested Benefits that has not already been allocated to employers, is allocated in the ratio that each employer’s past 5 years of contributions bears to the total of all active employers past 5 years of contributions and is “assigned” as that year’s “Unfunded Vested Benefits (UVB) pool share”.

- Each year after the UVB pool share has been allocated to an employer, it is written down by 5% until that year’s UVB pool share is exhausted at the end of 20 years, hence the name “20 Pool Method”.

CURRENT METHODOLOGY, continued

- The concept behind writing down every pool share by 5% per year, is a slow methodical way of continually reallocating Unfunded Vested Benefits from the weakest to the strongest employers in the Fund.
- Due to net investment losses since 2000, along with bankrupt employers who withdraw without paying their withdrawal liability, the strongest employers in the Fund have had their withdrawal liability increase disproportionately due to orphan liabilities.
- The likelihood of withdrawal liability is a detraction for a Fund in bringing in new employers.

CURRENT METHODOLOGY, continued

For example a sample 2011 Pool share of $100,000,000 was made up of the following:

- $35M increase in the value of Unfunded Vested Benefits between 12/2010 and 12/2011,
- $5M deminimis reduction/uncollectible amounts from a withdrawn employers, and
- $60M in reallocated active employer liabilities due to the 5% write-down of prior pool shares.

CURRENT METHODOLOGY, continued

- The $60M piece is being reallocated from weaker employers to stronger employers as the weaker employers 5 year contribution ratio declines and the stronger employers 5 year contribution ratio increases as a percentage of the total.

- For an example large dominant employer, while their own Pool shares had been written down by 5% lowering their liability by $20M, they were then allocated 40% of the entire $60M write-down or $24M. As a result their liability increased by $4M even before the allocation of the increase in benefits.

- It is this reallocation issue that is encouraging stronger employers to consider withdrawal.

PART II

THE HYBRID WITHDRAWAL LIABILITY METHOD

THE HYBRID WITHDRAWAL LIABILITY METHOD

- The goal of the Hybrid Withdrawal Liability Method is to incent current employers to settle their "existing withdrawal liability" via a discount, and to re-enter the Fund under a higher benefit structure than the employer can afford to provide in a single employer plan with little or no risk of incurring withdrawal liability in the future.

- Due to the low risk of incurring withdrawal liability, the Hybrid Method could also encourage new employers to enter the Fund.

- The first step in the process is to create an "Existing UVB Pool" and a "New UVB Pool".

THE HYBRID WITHDRAWAL LIABILITY METHOD, cont'd

- Part #1 – the "Existing UVB Pool" – Equal to the value of Unfunded Vested Benefits of all participants of all employers who were in the Fund prior to the effective date of the Hybrid Method, and who **did not agree** to:

  - withdraw,
  - settle their "Existing Pool" withdrawal liability, and
  - re-enter the Fund as a contributing employer.

  The "Existing UVB Pool" would continue to operate under the "20 Pool Method" currently in use.

<u>THE HYBRID WITHDRAWAL LIABILITY METHOD, cont'd</u>

- Part #2 - <u>"New UVB Pool"</u> – Equal to the value of Unfunded Vested Benefits of new employers and former employers who **<u>did agree to</u>**:
  - withdraw,
  - settle their "Existing Pool" withdrawal liability, and
  - re-enter the Fund as a contributing employer.

  - The value of Unfunded Vested Benefits would be based on future benefit accruals only less the portion of assets and earnings related to future contributions only.

  - The benefit design for the participants of these employers would be developed on a conservative enough basis to both provide a higher benefit level than is currently being provided, and to help fund the Unfunded liabilities of the entire Plan.

THE HYBRID WITHDRAWAL LIABILITY METHOD, cont'd

- The Trustees can select any acceptable method of allocating the Unfunded Vested Benefits within the New UVB Pool. The two methods that the PBGC has approved are the "Modified Presumptive Method" (also called the "Rolling 5" or "One Pool" method) and the "Attributive Method".

- The "Attributive Method" is more complex to administer because the Unfunded Vested Benefits allocated to an employer are directly based on the benefits earned by the participants of that employer and the contributions made and earnings thereon for that employer. However, should there be some uncollectible liability from a withdrawing employer or investment losses, it will still be allocated to all employers.

- The Trustees would have discretion over whether or not to permit a new employer into the Fund, thereby protecting the financial integrity of the New UVB Pool.

THE HYBRID WITHDRAWAL LIABILITY METHOD, cont'd

- The most unique feature of the Hybrid Method is the ability of the Fund to negotiate an arrangement with an long time employer who is in the Existing UVB Pool to settle their current withdrawal liability and re-enter the Fund as an employer in the New UVB Pool.

PART III

SETTLEMENT OF "EXISTING WITHDRAWAL LIABILITY" UNDER THE HYBRID METHOD

SETTLEMENT OF EXISTING UVB POOL WITHDRAWAL LIABILITY

- Any arrangement made between a Fund and an employer seeking to settle it's withdrawal liability and re-enter the Fund needs to make sense to both parties.
- From the employer's perspective, they would seek a discount because they would now be paying off withdrawal liability and, at the same time, be making new contributions to the Fund under the New UVB Pool.
- Higher discounts would be available for lump sum settlements because the Fund needs to increase investable assets to cover cash flow shortfalls thereby forestalling insolvency.

SETTLEMENT OF EXISTING UVB POOL WITHDRAWAL LIABILITY, continued

- From the Fund's perspective, it would help the Plan to receive both the withdrawal liability and to keep the employer contributing to the Fund because the new benefit design under the New UVB Pool will cost less than the contribution rates helping to pay off existing Unfunded Liabilities.

- However, if withdrawal liabilities are hitting the 20 year payment cap, some discount of employer liability is already "built in".

- The value of the "built in" discount varies from employer to employer based on the pattern of work levels and contribution rates.

SETTLEMENT OF EXISTING UVB POOL WITHDRAWAL LIABILITY, continued

- Typically, if every employer decided to settle it's liability over the 20 year maximum schedule in a lump sum, the Fund would still not be 100% funded.
- In determining the discount, the Fund would consider the value that the withdrawing/re-entering employer has to the continued funding of the Plan.
- In a real life example, the New England Teamsters Fund settled the UPS "existing withdrawal liability" at what appears to be a 50%+ discount. This settlement was exceptional because UPS was seeking to negotiate part-timers out of the Fund and because the NE Fund secured a 10 year guarantee of participation.

PART IV

ALTERNATIVE PLAN STRUCTURE FOR EMPLOYERS IN THE HYBRID NEW UVB POOL

ALTERNATIVE PLAN STRUCTURE

- Just as important as how withdrawal liabilities are settled is the plan design of the benefits to be provided in the future for employers in the New UVB Pool.

- Since there are no past service benefits, the cost of these benefits would be the Normal Cost of the Plan only.

- To establish a conservative benefit design in order to reduce the likelihood of withdrawal liability, we would select a level of benefits that could be provided based on a much lower and safer interest rate assumption such as 5%, or determine the level of benefits affordable at 7.5% and provide only a fraction of those.

ALTERNATIVE PLAN STRUCTURE, continued

- Because the intent is that the expected contributions would be sufficient to pay for the future benefits being earned plus a portion attributable to help fund the Unfunded, there would be no requirement that contribution rates increase.

- While the Trustees should establish a reasonable minimum required contribution level (i.e. $1.00/hr), there is no requirement that the re-entering employer return at the same contribution rate that existed prior to withdrawal.

PART IV

CONCLUSIONS

ADVANTAGES OF THE HYBRID METHOD

- New Employers – It is unlikely that they will experience withdrawal liability.

- Existing Employer who moves to New UVB Pool - Eliminate the risk of future reallocations of other weaker employer liabilities/orphan liabilities that are inherent in the Existing UVB Pool which aids in financial budgeting and disclosures and resolves concerns about being the "last employer standing".

- Existing Employer who does not move to New UVB Pool – New and existing employers in the New UVB Pool will be contributing more than the cost of benefits thus helping with funding. Existing employers in the New UVB Pool will be paying regular contributions plus withdrawal liability increasing incoming cash to the Fund.

ADVANTAGES OF THE HYBRID METHOD, continued

- Fund - Increased income especially in the case of lump sum settlements. It also gives the Fund a opportunity to retain employer who intend to withdraw, pay their withdrawal liability and put their union employees into a single employer company plan. Funding costs in multiemployer plans would be significantly lower than in single employer plans.

- Participants in New UVB Pool - Higher unit multipliers than under a Rehabilitation Plan.

- For existing employers looking to move into the New UVB Pool the relative value of the advantages lie in the settlement terms themselves (the art of the deal) which can be different from situation to situation.

TRUSTEE CONSIDERATIONS

- Select a method of allocating UVB in the New UVB Pool. The PBGC has already approved both the direct attribution and rolling years methods.
- Consider requiring existing employers who move from the Existing UVB Pool to the New UVB Pool to commit to staying in the Fund for a certain number of years.
- Establish a benefit design taking into account the goals of minimizing withdrawal liability in the "New UVB Pool" and helping to satisfy the existing Unfunded.
- Consider eliminating the application of the deminimis rule for employers in the New UVB Pool.
- Request approval from the PBGC to establish a Hybrid Method.