

Multiemployer Review

Update on issues affecting multiemployer plans

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Balance forward defined contribution plan challenges in turbulent times

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Due to the coronavirus outbreak, the recent economic downturn has had a significant impact for many participants' retirement accounts. At the lowest point to date in 2020, the S&P 500 was down over 30% and bonds did not fare much better, with returns less than 1% (based on the return of the iShare Core U.S. Aggregate Bond ETF). Unless participants were invested in a money market or stable value option, this market drawdown left participants with heavy losses in their accounts, even if only on paper. However, the downturn in the stock market has left defined contribution (DC) plans that only value participant accounts on a periodic basis in a predicament, based on how and when they pay distributions to their participants. This article provides an overview of the distribution process and why now may be a good time for trustees to consider moving the defined contribution plans to a daily valued environment.

Balance forward plans: Distributions

A balance forward plan is one where participant balances are valued on a periodic basis, such as monthly, quarterly, or annually. Many multiemployer plans in a balance forward environment are valued on an annual basis. With these types of plans, when a participant becomes eligible for a distribution and requests payment, that person will need to wait until the most recent valuation is completed. A valuation after the period closes can take weeks or months to complete, which can cause a long delay in payment from the plan, especially for those plans that are valued on an annual basis where the valuation may not be completed for several months after the end of the plan year. As a result, most plans upon request will immediately pay the participant 75% to 90% of the account balance based on the most recent (prior) valuation. This allows the participant to receive a portion of the account balance in a timely manner. Then, once the next valuation is completed, the participant will be paid the remaining amount of the balance, which takes into account the prior valuation, less what has already been distributed. This buffer of 10% to 25% allows for gains and losses to be factored into the second valuation to ensure that participants are paid the correct amount from their accounts. For example, if a participant requests a distribution on September 15 and a plan was last valued on December 31 of the prior year, the participant will get 75% to 90% of the distribution based on the previous December 31 balance. Once the most recent valuation is completed, the participant is paid the remaining balance—the account balance based on the prior December 31 value, less the initial distribution, plus the gains or losses from December 31 of the prior year to the current valuation date.

This works well when gains and losses of the investments are moderate, but when there has been a significant downturn in the investment performance, like the first quarter of 2020, it can create situations where participants are overpaid. As another example, if a plan allows a participant to be paid 90% of that person's account balance based on the previous valuation, but the losses are 15% on the next valuation, then the participant received 5% more than he or she should have. Not only would the participant not receive another distribution but the plan would also either need to request money back from the participant, which is unlikely, or it would need to spread the 5% overpayment to the other participants in the plan, which is usually the case. Neither situation is ideal but it is what many balance forward plans are facing in today's investment environment.

Daily valued plan: Distributions

The process is much simpler and efficient in a daily environment because the investments are valued each business day. Account activity, gains, and losses are accounted for in each participant account daily. As a result, when a participant requests a distribution that person receives 100% of the account balance based on that day's closing pricing. At that point, the participant has been paid the full account balance from the plan so there is no subsequent payment from the plan. In addition, all gains or losses are accounted for in the individual's account, up to that point in time, so it in no way impacts the accounts of other participants in the plan nor is the plan sponsor overpaying participants who decide (and are eligible) to leave the plan.

Investment pool

Almost all balance forward plans are trustee-directed, meaning participants do not have the ability to choose their investments. The investment pool is typically comprised of both equities and bonds with the split varying by plan, although typically the equity exposure ranges anywhere from 40% to 60%. The investment pool is usually managed with the help and oversight of an investment advisor who works with the trustees to determine the best allocation for their plan population. Some trustees prefer this arrangement over providing participants the ability to manage their own investments, where a participant can be too conservatively or too aggressively invested. There are varying reasons why trustees prefer to not allow participants to invest their contributions on their own and they are valid reasons.

Understandably, many trustees believe that if the plan moves to daily valuation they need to open the plan to self-direction. This does not need to be the case. As long as the majority (approximately 90%) of the assets can be valued daily there is nothing that prevents the plan from moving to daily valuation while keeping the plan trustee-directed. Having this type of arrangement can result in a win-win for both the participant and the trustees. Participants can receive a full distribution of accounts (in a timely manner), while trustees maintain oversight of the investments. The plan is further protected by avoiding situations where a participant has been overpaid. Moving to a daily valuation environment also allows participants to view their accounts any time they want as well as receiving quarterly statements, helping them be more in touch with the performance of their retirement accounts. It can be especially advantageous to those nearing retirement because they will have an accurate reflection of account balances.

Conclusion

There are other reasons that trustees may want to consider moving to daily valuation, such as goodwill from the participants or bringing visibility to a great benefit that can allow for better retirement preparation. However, the immediate concerns in the current economic downturn and how it is impacting the plan (and its participants) make this an ideal time for trustees to consider moving their plans to daily valuation. Participants who request distributions can receive full account balances without the sponsor worrying about overpaying individuals. Administratively, it is much more efficient while also making the distribution process easier and simpler for the participant to understand.



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