PARAMETRIC

Special Financial Assistance Program for Multiemployer Pension Plans

Frequently Asked Questions

The American Rescue Plan Act, signed into law on March 11, 2021, established the Special Financial Assistance (SFA) program to fund financially troubled multiemployer pension plans. A number of conditions apply relating to benefit increases, plan mergers, withdrawal liabilities, and actuarial assumptions, among other matters. Within these parameters, plan sponsors may wonder how to allocate SFA funds for optimal outcomes. Below we cover some key questions that can help sponsors think through how to put these assets to best use.

Which plans qualify for the SFA program?

The program is expected to provide $74 to $91 billion to around 200 plans, aiming to help them pay promised benefits through the year 2051. Sizes of the actual awards remain uncertain, since amounts are calculated based on liability projections and economic conditions at the time of application. Multiemployer plans qualify for an SFA award if deemed to satisfy any of the following conditions under section 4262.3 of the Employee Retirement Income Security Act of 1974 (ERISA):

- Critical and declining status plans
- Plans with a suspension of benefits
- Critical status plans
- Insolvent plans

At the highest level, the SFA's lump-sum amount is intended to cover actuarially projected benefit payments and administrative expenses through 2051 when combined with current plan assets and projected future contributions and investment returns on SFA and non-SFA assets. Suspended benefits for Multiemployer Pension Reform Act plans will also be reinstated, and missed payments will be reimbursed.

©2023 Parametric Portfolio Associates® LLC

Are there restrictions on the investment choices for SFA and non-SFA assets?

The program requires plans to invest their SFA assets separately from their non-SFA assets. Plans must invest 67% or more of their SFA assets in investment-grade fixed income securities—including fixed-rate US dollar bonds registered under the Securities Act of 1933 as well as bond funds permitted under section 4262.14 of ERISA—and cash. They may also invest up to 33% of their SFA assets in return-seeking assets, which include common stocks, permissible stock funds, 144A debt securities, and downgraded fixed income securities originally purchased for the SFA as investment-grade fixed income securities.

Plans can invest SFA assets in separately managed accounts or in funds that meet certain criteria. Plans must not supplement their permissible investments with derivatives that could increase risk, but they may continue to invest their non-SFA assets at their own discretion, within ERISA requirements.

What returns should plans assume for SFA and non-SFA assets?

The program assumes SFA assets will return the lesser of two numbers:

» The actuarial valuation rate used for Funding Standard Account purposes

» The average of the three segment rates under 303(h)(2)(c)(i), (ii), and (iii) (the first, second, and third segment rates for funding purposes) for the last four periods as of the application date, plus 67 basis points

The program further assumes non-SFA assets will return the lesser of the actuarial valuation rate used for Funding Standard Account purposes and the lowest third-segment rate for the last four periods as of the application date, plus 200 basis points.

Which investment strategies may make the most sense for plans applying for SFA funds?

Corporate fixed income: We believe plans should invest in high-quality corporate bonds with a low probability of downgrade or default. Investment-grade corporate bond yields now are significantly higher than the segment rates used to calculate the SFA amount, since the segment rates are averaged over 24 months. These rates may draw even lower, since the program selects the lowest yields from several months prior to the application date. Higher yields allow plans to extend the benefit-payment period.

Cash-flow matching: The SFA award may be sufficient in many cases for cash-flow matching all projected amounts through 2051. Cash-flow matching minimizes liquidity risk and removes market volatility, aside from defaulted bond payments, since the dollar value of the cash flows will be paid regardless of yield changes. A cash-flow matching strategy should typically result in a low level of trading. That said, matching cash flows more than 10 years into the future can be difficult with corporate bonds because of a lack of issuance at that maturity. It might be prudent in such cases for plans to match longer-dated cash flows using US Treasuries.

Plans should anticipate transitioning return-seeking assets to their plan's investment-grade fixed income allocation over time to maintain the 33% limitation. They can use the proceeds from this transition to lengthen the number of cash flows being matched. We recommend a prudent credit-selection and issuer-diversification process, since the SFA program counts corporate bond positions that lose their investment-grade ratings as return-seeking assets.

©2023 Parametric Portfolio Associates® LLC | For institutional investor use only. Not for use with the public.

Why work with Parametric?

When opportunities arise for plans to access new funds, it's vital to prepare to allocate those funds wisely and efficiently. Parametric has more than 30 years of experience building customizable, systematic, cost-effective fixed income solutions. We rely on proprietary portfolio-construction algorithms and conservative credit research to build portfolios, including laddered bond structures and portfolios seeking to match liabilities. As of December 31, 2022, we manage $35 billion in these types of mandates using a variety of physical bonds.

Parametric's cash-flow-driven approach involves managing exposures and risks thoughtfully as we build a high-quality and well-diversified bond portfolio. We manage liquidity risk by closely matching coupon and principal payments with projected cash flows while seeking to maximize yield. We also manage idiosyncratic risk by using a conservative security-selection process, backed by an experienced team of credit researchers who focus primarily on principal protection.

About

Parametric Portfolio Associates® LLC ("Parametric"), headquartered in Seattle, is registered as an investment advisor with the US Securities and Exchange Commission under the Investment Advisers Act of 1940. Parametric is a leading global asset management firm, providing investment strategies and customized exposure management directly to institutional investors and indirectly to individual investors through financial intermediaries. Parametric offers a variety of rules-based investment strategies, including alpha-seeking equity, fixed income, alternative, and options strategies. Parametric also offers implementation services, including customized equity, traditional overlay, and centralized portfolio management. Parametric is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley, and offers these capabilities through offices located in Seattle, Boston, Minneapolis, New York, and Westport, Connecticut.

Disclosures

This material may not be forwarded or reproduced, in whole or in part, without the written consent of Parametric. Parametric and its affiliates are not responsible for its use by other parties.

This information is intended solely to report on investment strategies and opportunities identified by Parametric. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument.

Past performance is not indicative of future results. The views and strategies described may not be suitable for all investors. Investing entails risks, and there can be no assurance that Parametric will achieve profits or avoid incurring losses. Parametric and Morgan Stanley do not provide legal, tax, or accounting advice or services. Clients should consult with their tax or legal advisor prior to entering into any transaction or strategy described herein.

Charts, graphs, and other visual presentations and text information were derived from internal, proprietary, or service vendor technology sources or may have been extracted from other firm databases. As a result, the tabulation of certain reports may not precisely match other published data. Data may have originated from various sources, including, but not limited to, Bloomberg, MSCI/Barra, FactSet, or other systems and programs. Parametric makes no representation or endorsement concerning the accuracy or propriety of information received from any third party.

Parametric uses rules-based, proprietary investment techniques and analyses in making investment decisions. These strategies seek to take advantage of certain quantitative or behavioral market characteristics identified by Parametric, utilizing rules-based country, sector, and commodity weighting processes, structured allocation methodologies, and disciplined rebalancing models. These investment strategies have not been independently tested or validated, and there can be no assurance they will achieve the desired results.

A portfolio's ability to generate income will depend on the yield available on the securities held by the portfolio. In the case of equity securities, changes in the dividend policies of companies held by a client portfolio could make it difficult for the portfolio to generate a predictable level of income. The use of dividend-capture strategies to generate income will generally expose a client portfolio to higher portfolio turnover, increased trading costs, and the potential for capital loss or gain, particularly in the event of significant short-term price movements of stocks subject to dividend capture trading.

Corporate debt securities are subject to the risk of the issuer's inability to meet principal and interest payments on the obligation and may also be subject to price volatility due to such factors as interest rate sensitivity, market perception of the creditworthiness of the issuer, and general market liquidity. When interest rates rise, the value of corporate debt securities can be expected to decline. Debt securities with longer maturities tend to be more sensitive to interest rate movements than those with shorter maturities. Company defaults can impact the level of returns generated by corporate debt securities. An unexpected default can reduce income and the capital value of a corporate debt security. Furthermore, market expectations regarding economic conditions and the likely number of corporate defaults may impact the value of corporate debt securities.

All contents ©2023 Parametric Portfolio Associates® LLC. All rights reserved. Parametric Portfolio Associates® and Parametric® are trademarks registered with the US Patent and Trademark Office and certain foreign jurisdictions.

Parametric is headquartered at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies, or to request a copy of Parametric's Form ADV or a list of composites, contact us at 206 694 5500 or visit www.parametricportfolio.com.