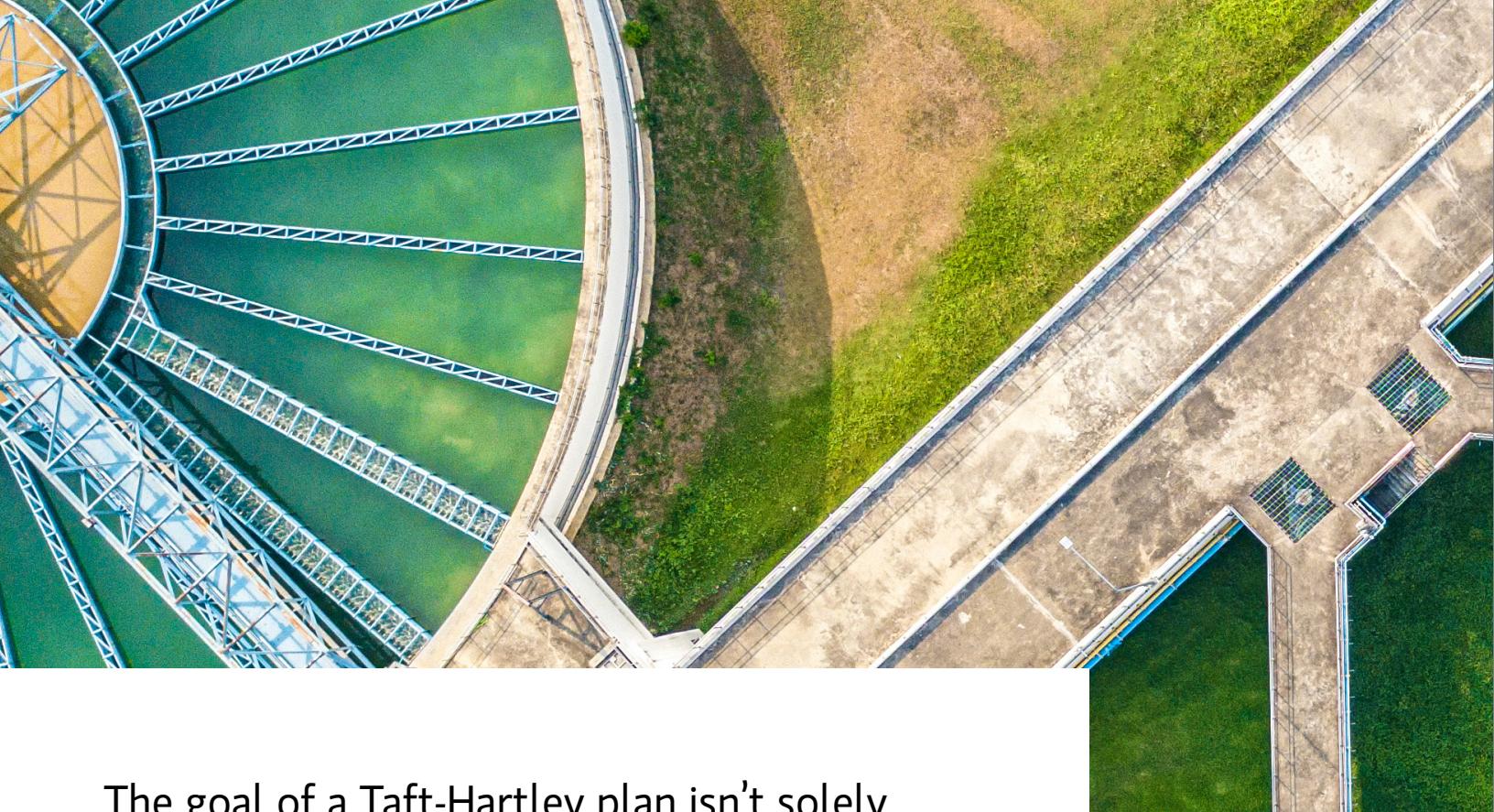


Taft-Hartley Plan Fundamentals:

What Trustees Need to Know About
Building a Healthy Plan



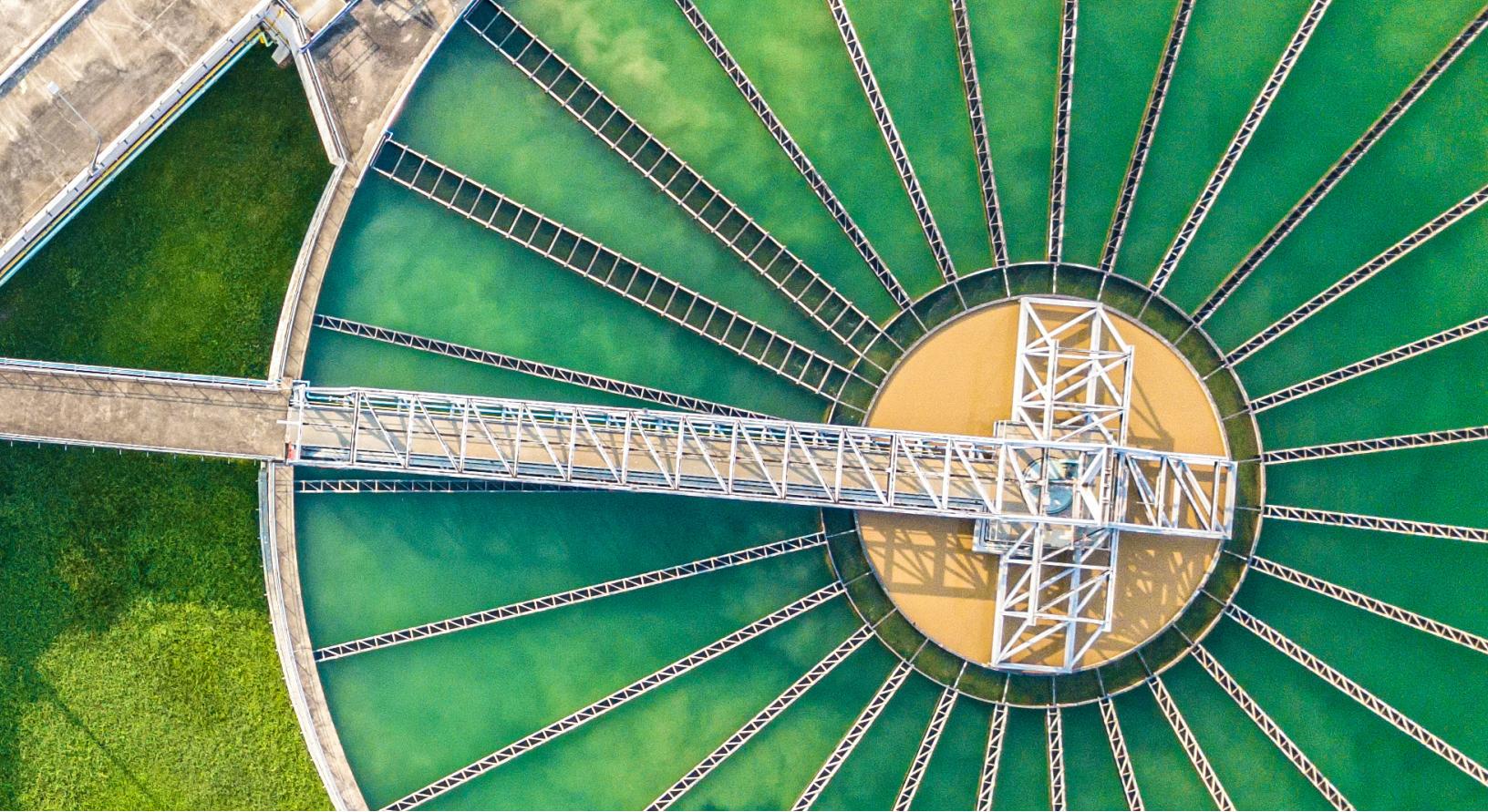


The goal of a Taft-Hartley plan isn't solely to generate investment returns that beat a benchmark. Rather, the primary mission of the board of trustees overseeing a Taft-Hartley plan is to protect and deliver the benefits promised to workers and their families, without requiring additional contributions from the employer.

Achieving this objective is not a straightforward task. It requires an in-depth, nuanced understanding of each plan and its workforce, as well as numerous projections about the macroeconomic and financial market conditions affecting the plan's assets.

For trustees, being a good steward of the plan's assets starts with knowing the mechanics of how a Taft-Hartley plan operates and the relationship among key factors such as the discount rate, funded status, and investment strategy. Here, we explain these elements and examine the roles that investment consultants and actuaries play in helping trustees strengthen and maintain the plan's health.

Defined benefit plans are complicated; trustees should consult with legal and tax advisors.



Elements of a Healthy Plan

For Taft-Hartley and other defined benefit retirement plans, the ultimate goal is **perpetual solvency**. Perpetual solvency simply means that a plan will *always* be able to pay the retirement benefits it owes to its participants.

Hitting this goal requires having enough assets and sufficient **liquidity**—cash or assets that can quickly be sold without a significant penalty or discount—to make scheduled payments to beneficiaries. Without adequate assets or liquidity, the plan will be forced to choose between two unappealing options: increase contributions or reduce benefits.

From Contributions to Benefits: How Money Flows in a Taft-Hartley Plan

Contributions

Money put into the plan by the employer(s) at an agreed-upon frequency and amount. The amount is typically based on the number of hours worked by eligible employees.

Retirement Plan Assets

Contributions are invested to generate a return that meets or exceeds the discount rate, taking into account the plan's risk and liquidity constraints.

Distribution of Benefits

Regular payments are made to plan participants who are retired, disabled, or otherwise eligible for benefits.

A critical indicator of a Taft-Hartley plan's health is its **funded status** (or funded ratio). This is a measure of the amount of money a plan holds at a point in time (its **assets**) relative to the amount it will need to make future benefit payments (its **liabilities**). Funded status is calculated by dividing the value of plan assets by its plan liabilities. This ratio indicates if a plan is considered "fully funded" or "underfunded."

$$\text{Funded Status} = \frac{\text{Value of Plan Assets}}{\text{Plan Liabilities}}$$

For example, Plan A's assets equal \$110 million and its liabilities are \$100 million; thus, its funded status is 110%, and the plan is considered fully funded.

PLAN A

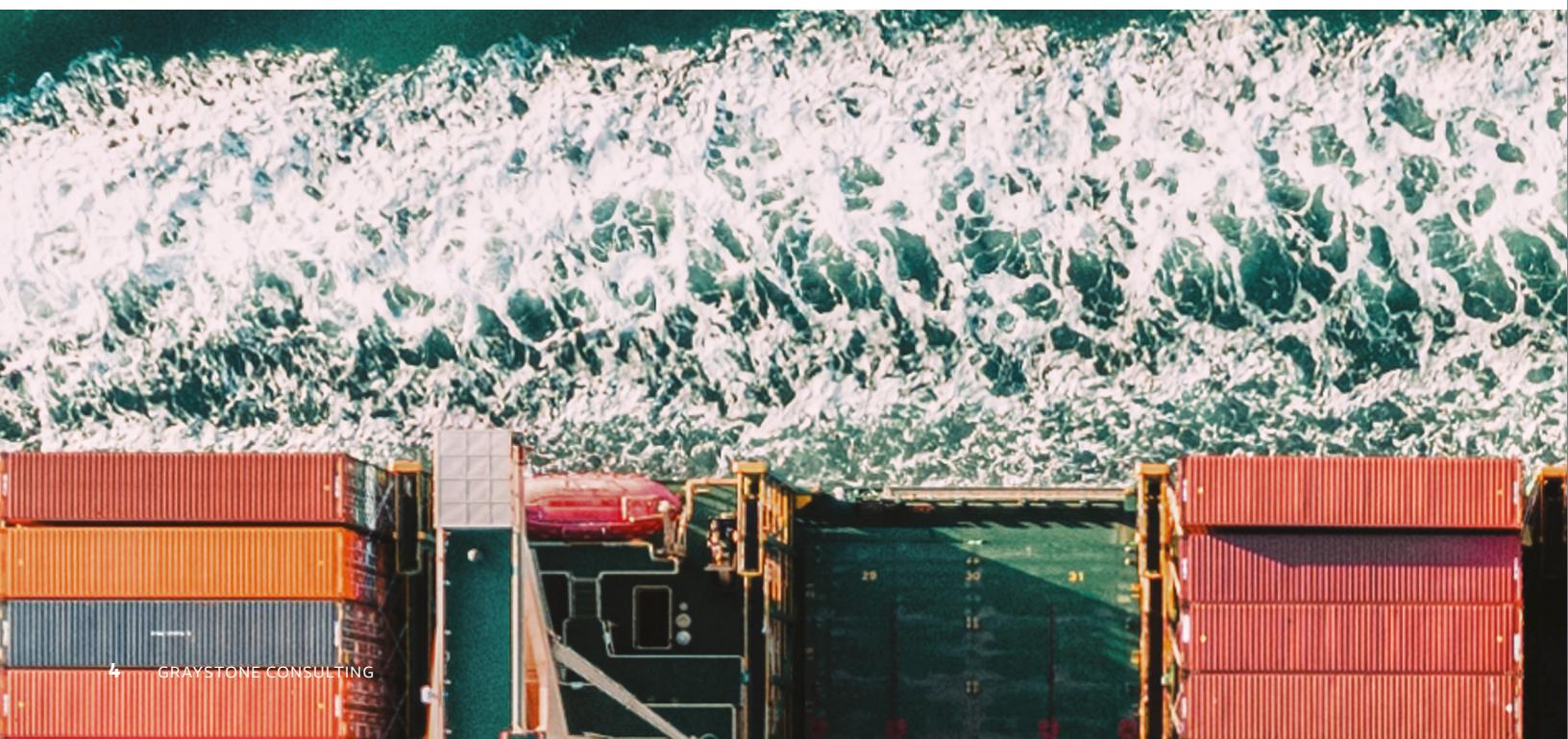
$$\frac{\$110 \text{ Million in Assets}}{\$100 \text{ Million in Liabilities}} = 1.1, \text{ or } 110\%$$

Meanwhile, Plan B has \$200 million in assets but \$250 million in liabilities; its funded status is 80%, and the plan would be considered underfunded.

PLAN B

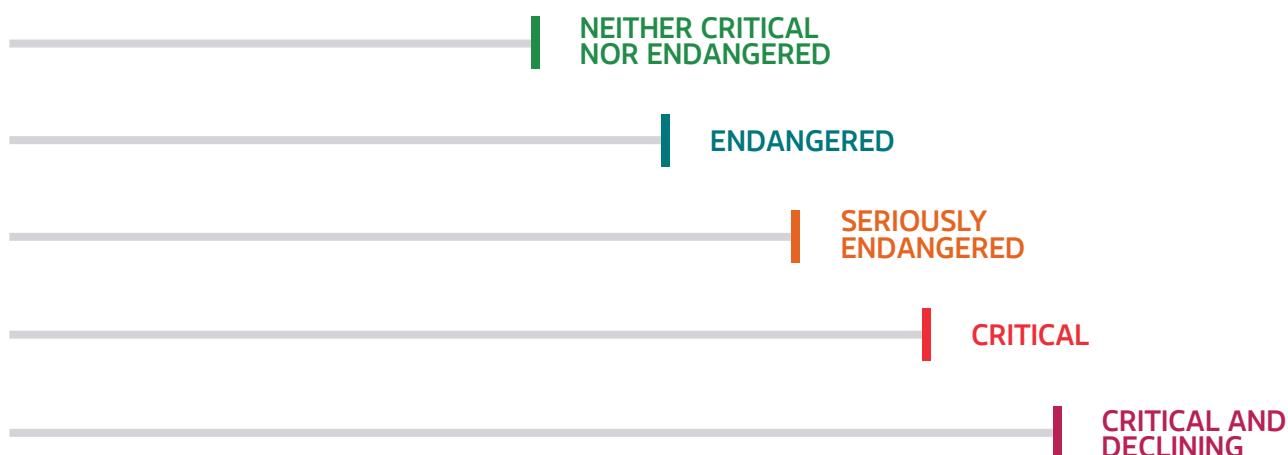
$$\frac{\$200 \text{ Million in Assets}}{\$250 \text{ Million in Liabilities}} = 0.8, \text{ or } 80\%$$

Being fully funded or underfunded isn't a black-or-white proposition. Rather, a plan's health should be viewed across a spectrum based on the degree to which the plan is underfunded and the trajectory of the plan's finances. See the nearby sidebar about the color-coded **zone certifications** created by Congress to standardize measures of plan health.

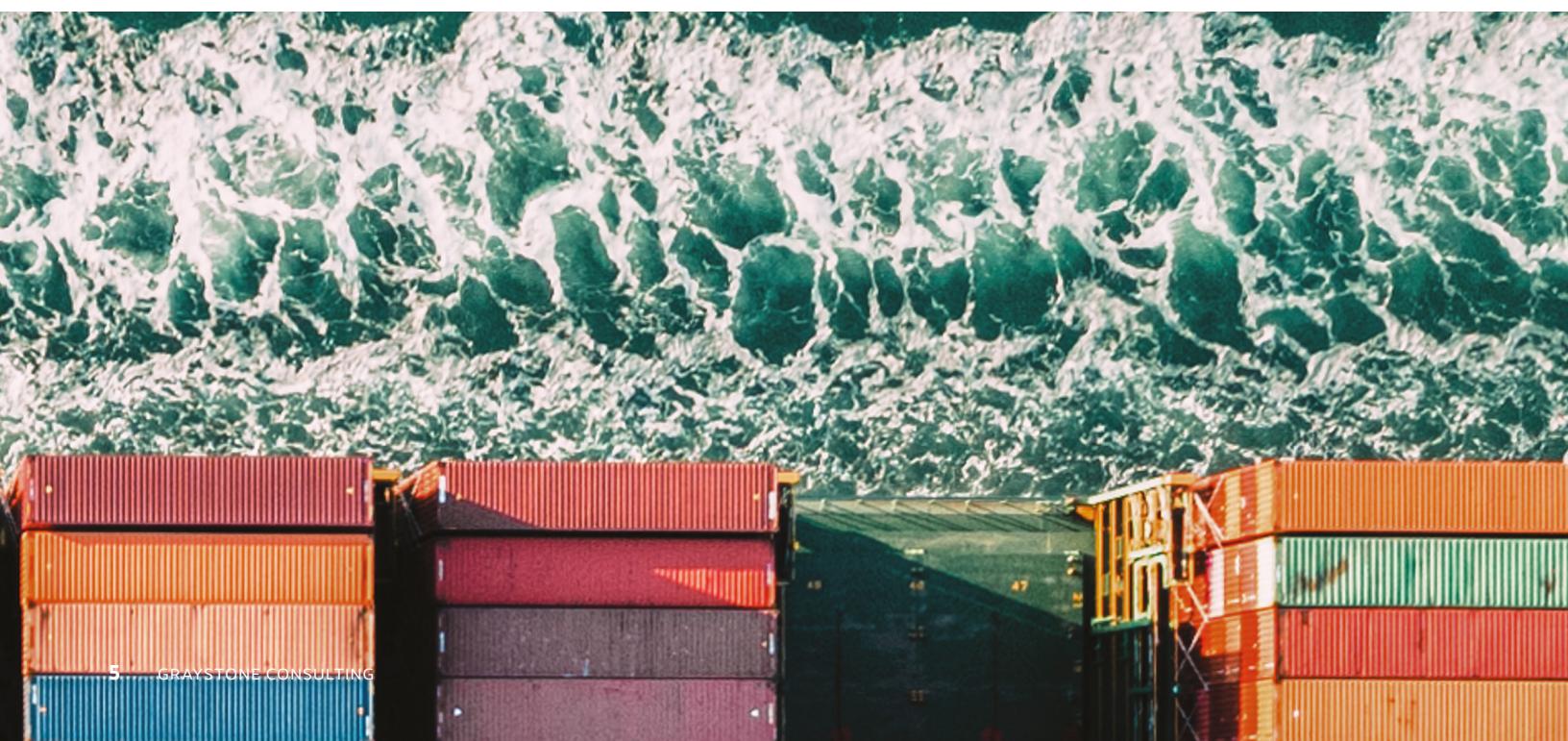


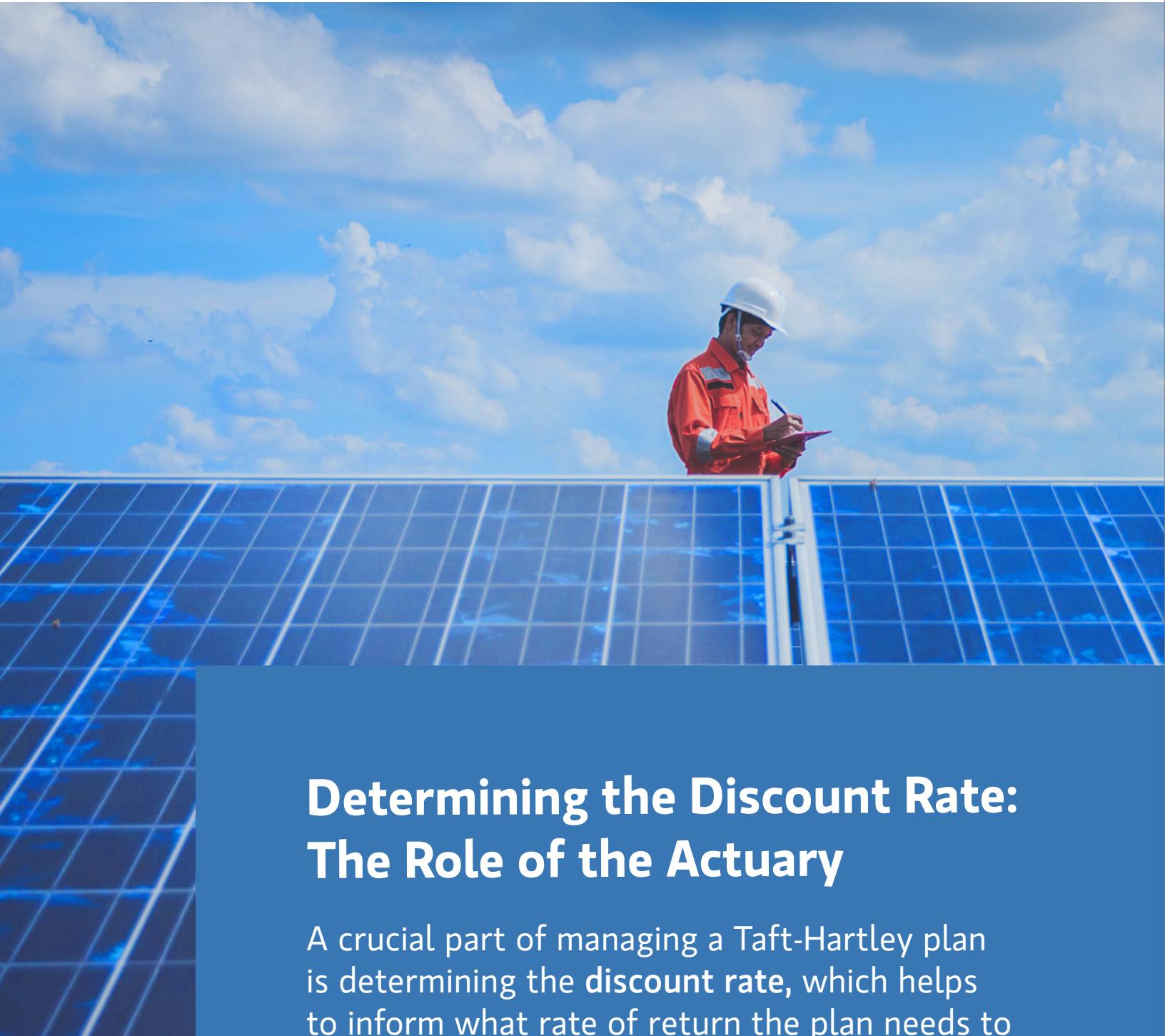
Multi-Employer Plan Funded Status Zone Certifications

To establish standard definitions of Taft-Hartley plan health and help regulate how organizations manage their plans' health, Congress has implemented through legislation several policies and guidelines, including a set of color-coded zone certifications. The zones are defined by a combination of current funded status (e.g., above/below 80% funded), forward-looking assumptions (e.g., expected to have a funding deficit in the next six years), or other factors.



Of course, the ideal outcome is for a plan to be classified in the green zone. If a plan is determined to be endangered or seriously endangered, it must adopt an improvement plan that may include increased contributions or other actions. If the plan is deemed to be in either of the critical red zones, it must undertake a more drastic, longer-term plan to improve its funded status.





Determining the Discount Rate: The Role of the Actuary

A crucial part of managing a Taft-Hartley plan is determining the **discount rate**, which helps to inform what rate of return the plan needs to achieve on its investments to meet its obligations to current and future beneficiaries. The discount rate is determined by the plan's **actuary** and reflects the actuary's views on the expected return on assets over a 20+ year period.



The actuary first performs a **liability analysis** to project how much the plan will owe in benefit payments over the long term. This is not a simple process. The actuary must consider several inputs and make multiple forward-looking **actuarial assumptions** to account for fluctuating market conditions and changing plan-specific demographics. These assumptions are made for several factors that include:



Market Factors

- Asset Class Returns
- Inflation
- Interest Rates
- Wage Growth

Demographic Factors (plan-specific)

- Withdrawal Rates
- Contributions
- Retirement Activity
- Mortality Rates

After determining the expected future benefit payments, the actuary calculates the value of those payments today ("discounts" it) to arrive at the plan's liability. This calculation incorporates the effects of compounding interest, reinvestment, and other inputs to arrive at the discount rate.

By setting the discount rate, the actuary is in effect saying to the investment consultant, "Based on what the plan will owe in the future and how much money it has today, you'll need to achieve *this* level of return each year to meet the plan's benefit obligations." The discount rate does not change often; it is reviewed annually, and any movement is small—typically a fraction of a percent at a time.

One of the actuary's primary responsibilities is to determine the discount rate, which helps to inform the performance target for the plan's investment portfolio.



Investing the Assets: The Role of the Consultant

Many Taft-Hartley plan trustees share the investment program's fiduciary responsibilities with an investment consultant, who acts as an independent fiduciary to the plan. In other cases, for boards of trustees that wish to retain sole fiduciary responsibility, the consultant assumes the role of trusted advisor in creating the plan's investment strategy.

Regardless of how the consultant's role is defined, the goal is to design a portfolio to meet or exceed the return target at the lowest level of risk possible and within the confines of the plan's anticipated payments or outflows.

A central consideration in this process is the plan's **illiquidity tolerance**. This concept refers to the plan's ability to invest in assets that are more difficult to sell quickly without a discount or penalty, such as real estate, private equity, private credit, and other non-publicly traded assets. These investments typically offer a higher rate of return than publicly traded assets in exchange for locking them up for a longer time period (i.e., an **illiquidity premium**). Generally speaking, plans with higher regular withdrawal requirements have less capacity to harvest this illiquidity premium than healthier plans.

In constructing and managing the portfolio, the plan and its consultant will incorporate both **strategic asset allocation** and **tactical asset allocation** into their process. Strategic allocations take a higher-level, top-down, and longer-term approach to set the course for a portfolio by determining target allocations to specific asset classes. A critical input into strategic asset allocation decisions is the consultant's **capital market assumptions**, which represent projected returns for various asset classes.

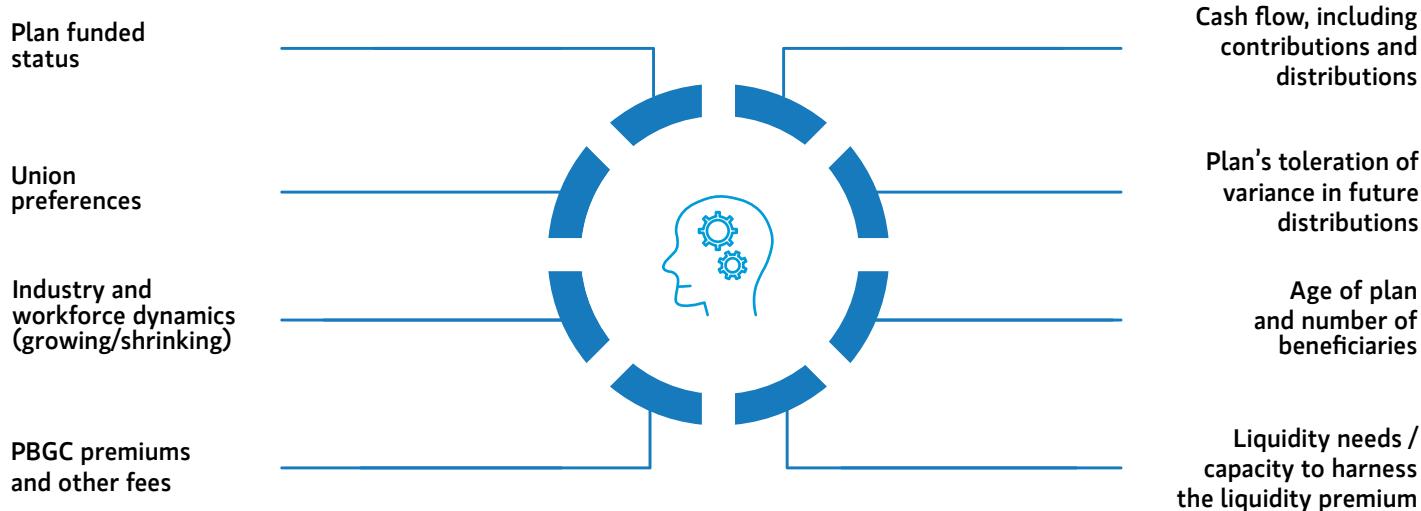


Tactical investments, on the other hand, capture timely opportunities when they arise and can be used to maintain the required return over a shorter horizon (e.g., 10 years), while managing risk without forcing a change in discount rate. Using both strategic and tactical asset allocation can be an effective way to manage and monitor the plan's investments with a long-term view, while still being opportunistic.

The strategic target allocations typically are codified in the plan's **investment policy statement (IPS)**, which is a document that describes the plan's goals and objectives, along with the target asset allocation the consultant will use to manage the plan. The IPS also defines permitted variance "bands" that allow the plan to exceed or fall below the stated target in each asset class; these bands provide flexibility for tactical decisions without the need to automatically rebalance the portfolio's allocations.

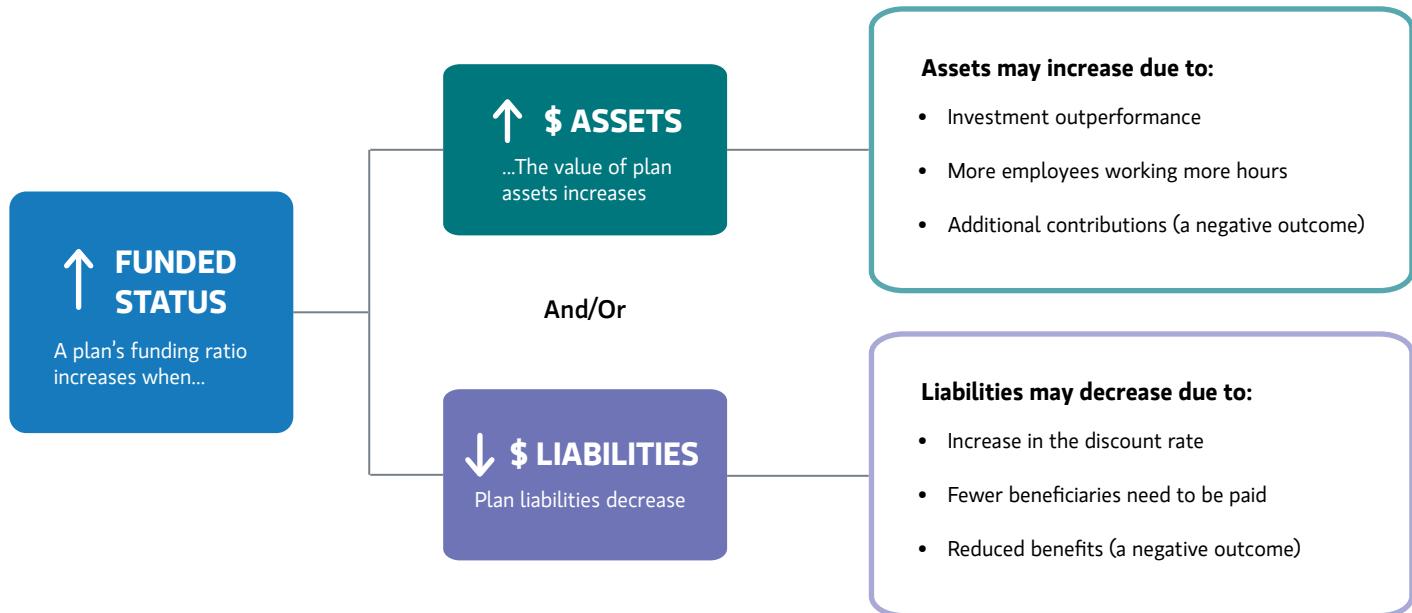
In addition to projecting asset class returns and macroeconomic conditions, creating the right investment strategy requires constantly assessing a host of other factors that are specific to each Taft-Hartley plan. While some factors may already be integrated into the actuary's calculations, the plan trustees and consultant must thoroughly understand and take all factors into account when making investment decisions. For example, the portfolio should be constructed using investments that provide adequate liquidity if payment obligations change due to shifting demographics of the plan's beneficiaries.

Non-Market Factors That Influence Taft-Hartley Portfolio Construction

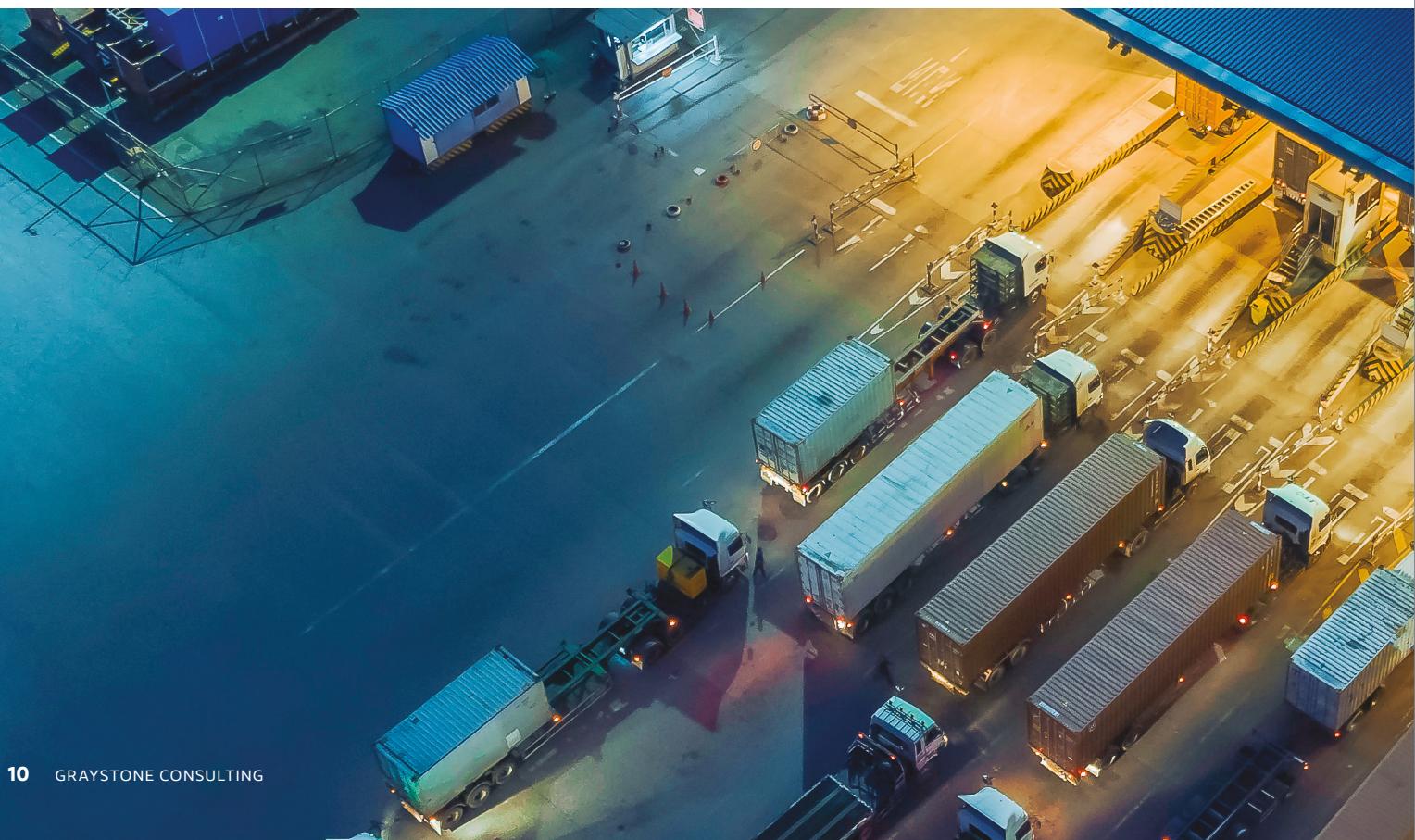


PBGC premiums are fees paid to the Pension Benefit Guaranty Corporation (PBGC), an independent entity that insures retirement benefits for defined benefit plan participants.

Putting It All Together: Factors That Can Affect a Plan's Funded Status



Defined benefit plans are complicated; trustees should consult with legal and tax advisors



Graystone Consulting: A Trusted Partner for Improving Plan Health

Partnering with the right investment consultant can play a vital role in strengthening a Taft-Hartley plan's health and pursuing perpetual solvency. In addition to building portfolios designed to achieve the discount rate within the plan's risk and liquidity constraints, your investment consultant can educate trustees and members on the latest regulatory and market trends facing Taft-Hartley plans.

At Graystone Consulting, we are proud to be a trusted fiduciary to Taft-Hartley plans and their trustees, working on behalf of their participant members. Graystone has a specialized practice of experienced consultants who focus on Taft-Hartley plans, and we work with more than 600 Taft Hartley pension plans, annuity plans, health and welfare funds, and other types of multi-employer funds. These clients represent more than \$80 billion in assets across trades and sectors.



\$515.7
BILLION

in total institutional assets
under management¹



50
YEARS

of experience advising
institutional clients



280+
CONSULTANTS

serving institutional clients²

¹As of December 31, 2022. Mandates include all Assets Under Management and Assets Under Advisement.

²As of December 31, 2022.



Let's Talk

We look forward to starting the conversation on how we can help.

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