JULY 2021

INSTANT INSIGHTS
UPDATE ON THE BUTCH LEWIS ACT

The Butch Lewis Act (the Act) was signed into law as part of the 'American Rescue Plan' in March 2021. It contains the Special Financial Assistance (SFA) program for certain multi-employer pension plans facing severe economic challenges (see: The Butch Lewis Act: A Solutions-Based Perspective for more).

On July 9, 2021, the Pension Benefit Guaranty Corporation (PBGC) announced its interim final ruling on the Act. The 123-page document is available here.

WHAT DID WE LEARN FROM THE RULING?

Table 1: Summary of Butch Lewis Act interim final ruling[1]

Element of legislation	Clarification
Size of SFA	Based on consideration of **all** projected resources and obligations; determined as the difference in present value of all 'obligations' less all 'resources' though plan year ending in 2051. • **Obligations include** benefit payments and administrative expenses. • **Resources include** assets, contributions, withdrawal liability payments and income.
Discount rate	No change. Confirmed as **lesser of**: • Most recent plan interest rate assumption prior to January 1, 2021,or • 3rd segment rate + 200bp[2]
Permitted investments	US dollar investment grade (IG) fixed income assets. • 5% limit on bonds downgraded to high yield (must be IG at time of purchase) • Foreign issuers allowed if the debt is denominated in US dollars • At least one-year of obligations must be held in "permitted investments" • Derivatives allowed, but no leverage permitted

[1] For illustrative purposes only

[2] Under the legislation, the discount rate is based on assumptions used in a plan's most recent status determination filing from before January 1, 2021 subject to a cap based on the Treasury "third segment rate" for the applicable month plus 200bp.

Priority groups	'Priority group' system to manage the flow of applications for the SFA • Designed to focus on most severely impacted plans and participants first (i.e., 'priority groups' 1 & 2, respectively) • Application window opens July 9, 2021, for insolvent plans and those projected to become insolvent before March 11, 2022 (i.e., 'priority group' 1 plans)
Next steps	**PBGC 30-day comment period**. PBGC seeking input on: • Permitted investments • Requirement to hold one-year of obligations in "permitted investments"

Request for comment period

The PBGC will now hold a 30-day comment period on these elements, concerning potential unintended consequences on plan health and potential benefits of allowing synthetic fixed income securities, insurance contracts, hybrid securities, preferred stock and other vehicles.

Insight and its ultimate parent company, Bank of New York (BNY) Mellon, intend to respond with supporting data as requested, consistent with our early support of the Act and our discussions with the PBGC, the Department of Labor, the Department of the Treasury and the Department of Commerce prior to the final interim rule.

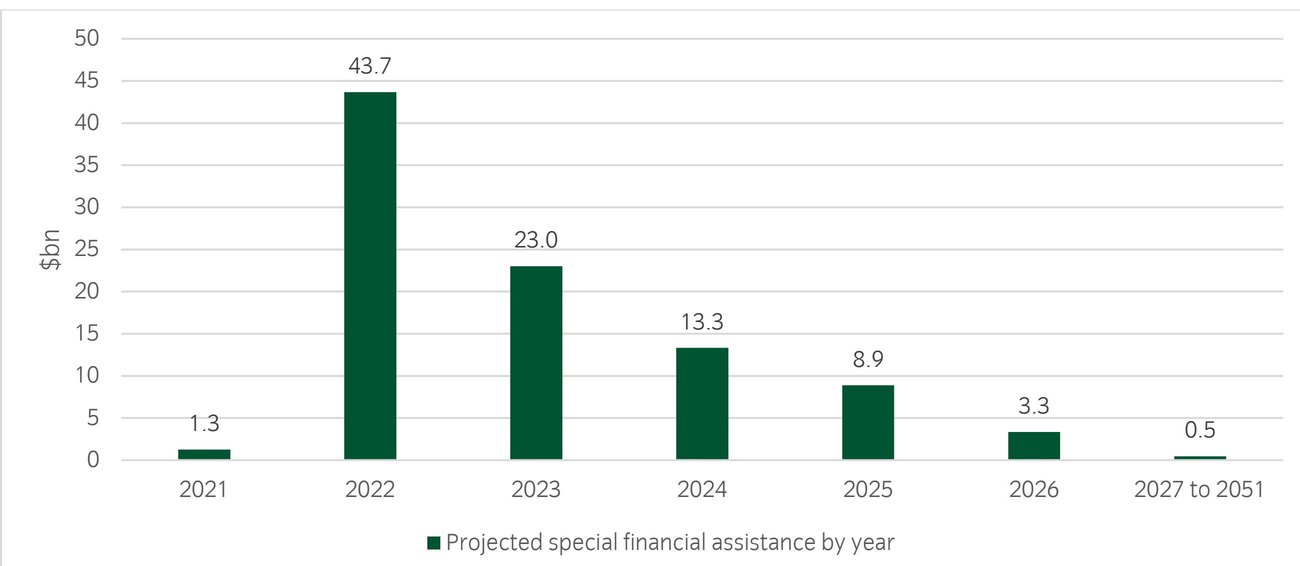
CLARIFICATION ON AMOUNT OF SFA FUNDS

The lump sums under the SFA are still designed to cover obligations through the plan year ending in 2051 and will need to be segregated from existing assets.

However, the SFA lump sums will be based on a one-time projection of the plan's net 'obligations and resources', thus will need to factor existing assets, contributions and withdrawal liability payments into the application for funding.

The PBGC's projection of overall assistance remains high, currently at ~$94bn to over 200 plans (Figure 1).

Figure 1: PBGC estimates of SFA payments per year[3]



[3] PBGC, July 2021

POTENTIAL CHALLENGES GIVEN THE RULE CLARIFICATIONS

1) Significant risk of funds being exhausted prior to 2051

The new interpretation of lump sums under the SFA make it more likely the funds will be exhausted prior to 2051, rather than last through 2051, as intended.

A key consideration is that poor investment performance in the early years of the SFA program may result in increased insolvency as plans experience regular outflows to meet obligations (see The Butch Lewis Act: A Solutions-Based Perspective).

This also implies inequalities for younger, active workers who are left with no benefits despite years of participation and contributions. This possibility, and the precedent now set by the Act, effectively leaves the door open for a second round of SFA in 10 to 20 years.

2) Most plans receiving relief will have SFA calculated with a ~5.5% discount rate

Insight and BNY advocated for a lower liability discount rate under the Act. However, as the current rules are mandated by statute, the regulators had no option to adjust it.

As such, **we estimate a ~5.5% pa discount rate for most plans** (in line with the third segment rate plus 200bp)[4]. However, some plans (such as Central States Pension Fund), have disclosed a lower rate in form 5500, and thus will use discount rates **closer to ~3% pa[4]**.

IG bond yields are currently ~3%, meaning that plans with lower discount rates can potentially fully immunize their liabilities until 2051, using their segregated SFA portfolio. However, plans with higher discount rates will need to take additional risk to try to generate higher returns consistent with the 2051 end date.

3) No guidance on existing assets

A potential option for plans that need higher returns is to 're-risk' their existing (non-SFA segregated) assets. This is concerning to us particularly given multiemployer plans are moving into the 'decumulation' phase of their lifecycle (resulting in regular outflows) and equity valuations are near all-time highs. The PBGC has not provided any guidance on non-SFA allocations.

However, the PBGC has understood the concerns raised by commenters, including Insight, and has stated it is seeking an appropriate balance between investment 'certainty and safety' and plan flexibility.

POTENTIAL INVESTMENT STRATEGY IMPLICATIONS FOR ELIGIBLE PLANS

As plans begin the application process, we continue to believe it is important for them to balance the need to generate return, manage liability risks and generate cashflows to maximize the certainty that the assets will last through 2051.

Corporate bonds across different maturity profiles, non-US developed and emerging market bonds, global structured credit and / or interest rate overlays can play a role in meeting these needs.

Plans with lower discount rates: Those plans that have valuation interest rate assumptions in line with current market yields (~3%) will benefit from larger SFA grants and increased flexibility to pursue high-certainty liability-driven investing approaches. With a liability-driven investing approach, investors can hedge liability interest rate risks using IG fixed income assets within their SFA allocation.

Plans with higher discount rates: For plans with high interest rate assumptions, the amount of SFA received may not be sufficient to meet long-term obligations given current market yields; we believe this will be the case for the majority of plans. In this situation, plans will need to consider higher return and, consequently, higher risk strategies. Investors may wish to consider equity downside protection strategies, to increase the certainty of meeting the plans' required returns by protecting the downside against 'Black Swan' events.

In either case, a cashflow-driven investing approach, where a plan's investment income matches its cash obligations, is essential in our view. This reduces the possibility of being forced to sell assets during a downturn (which would crystallize losses), allowing the market to realize long-term returns and thus reducing the risk of plans becoming insolvent.

We welcome the opportunity to discuss implications of the Butch Lewis Act with you. If you are interested, please do not hesitate to get in touch.

---

[4] Public data, Insight calculations. Under the legislation, the discount rate is based on assumptions used in a plan's most recent status determination filing from before January 1, 2021 subject to a cap based on the Treasury "third segment rate" for the applicable month plus 200bp. The discount rate cap is expected to apply in most cases. Source BAML curve data at June 30, 2021 before investment and other expenses are deducted. For illustrative purposes only.

FIND OUT MORE

Insight Investment
200 Park Avenue, 7th Floor
New York, NY 10166
212-527-1800

Client Relationship Management
institutionalna@insightinvestment.com

Consultant Relationship Management
consultantsna@insightinvestment.com

@InsightInvestUS
company/insight-investment-north-america
www.insightinvestment.com

IMPORTANT INFORMATION

IMPORTANT DISCLOSURES

Insight does not provide tax or legal advice to its clients and all investors are strongly urged to consult their tax and legal advisors regarding any potential strategy or investment.

Information herein may contain, include or is based upon forward-looking statements within the meaning of the federal securities laws, specifically Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include all statements, other than statements of historical fact, that address future activities, events or developments, including without limitation, business or investment strategy or measures to implement strategy, competitive strengths, goals expansion and growth of our business, plans, prospects and references to future or success. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Words such as ‘anticipate’, ‘estimate’, ‘expect’, ‘project’, ‘intend’, ‘plan’, ‘believe’, and other similar words are intended to identify these forward-looking statements. Forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many such factors will be important in determining our actual future results or outcomes. Consequently, no forward-looking statement can be guaranteed. Our actual results or outcomes may vary materially. Given these uncertainties, you should not place undue reliance on these forward-looking statements.

Insight and BNY Mellon Securities Corporation are subsidiaries of BNY Mellon. BNYMSC is a registered broker and FINRA member. BNY Mellon is the corporate brand of the Bank of New York Mellon Corporation and may also be used as a generic term to reference the Corporation as a whole or its various subsidiaries generally. Products and services may be provided under various brand names and in various countries by subsidiaries, affiliates and joint ventures of the Bank of New York Mellon Corporation where authorized and regulated as required within each jurisdiction. Unless you are notified to the contrary, the products and services mentioned are not insured by the FDIC (or by any government entity) and are not guaranteed by or obligations of the Bank of New York Mellon Corporation or any of its affiliates. The Bank of New York Mellon Corporation assumes no responsibility for the accuracy or completeness of the above data and disclaims all expressed or implied warranties in connection there with. Personnel of certain of our BNY Mellon affiliates may act as: (i) registered representatives of BNY Mellon Securities Corporation (in its capacity as a registered broker-dealer) to offer securities, (ii) officers of the Bank of New York Mellon (a New York chartered bank) to offer bank-maintained collective investment funds and (iii) associated persons of BNY Mellon Securities Corporation (in its capacity as a registered investment adviser) to offer separately managed accounts managed by BNY Mellon Investment Management firms.

Disclaimer for Non-US Clients: Prospective clients should inform themselves as to the legal requirements and tax consequences within the countries of their citizenship, residence, domicile and place of business with respect to the purchase and ongoing provision of advisory services. No regulator or government authority has reviewed this document or the merits of the products and services referenced herein.

This document is directed and intended for ‘institutional investors’ (as such term is defined in various jurisdictions). By accepting this document, you agree (a) to keep all information contained herein (the ‘Information’) confidential, (b) not use the Information for any purpose other than to evaluate a potential investment in any product described herein, and (c) not to distribute the Information to any person other than persons within your organization or to your client that has engaged you to evaluate an investment in such product.

Telephone conversations may be recorded in accordance with applicable laws.