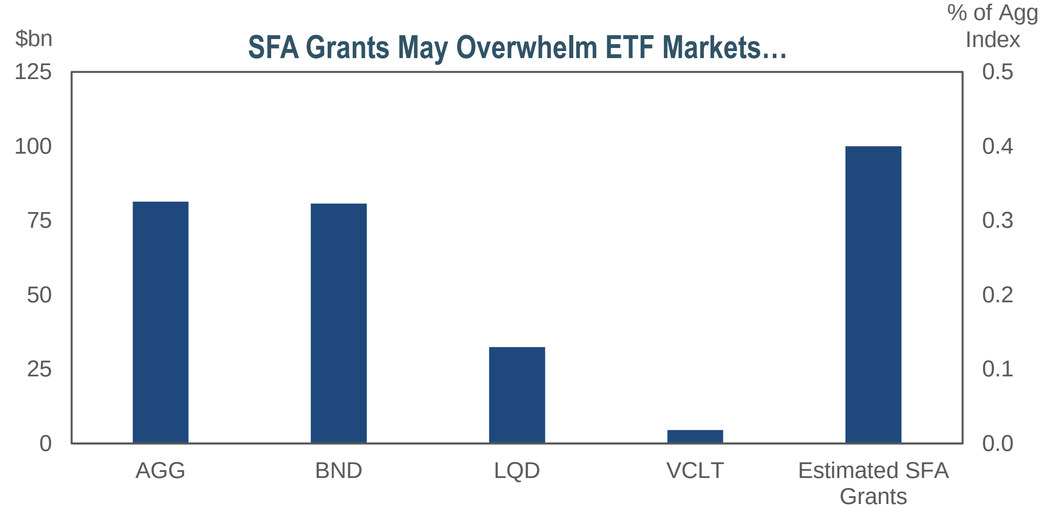
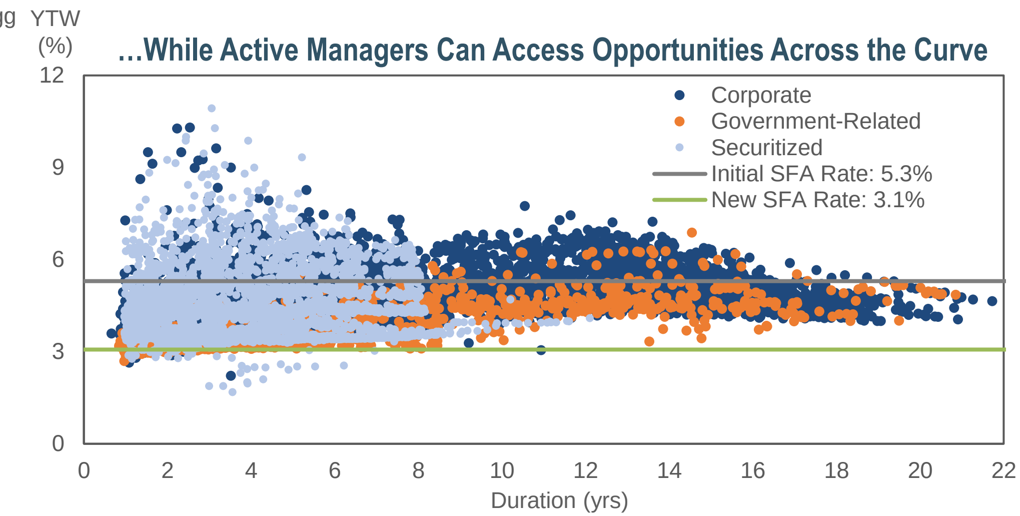
July 27, 2022

ARPA Final Ruling: Lower Discount Rate Expands SFA Investable Universe





- The American Rescue Plan (ARPA) Act, enacted March 2021, contained multiemployer pension relief under the Special Financial Assistance Program (SFA). On July 6th, the Pension Benefit Guaranty Corporation (PBGC) issued its Final Rule, clarifying SFA provisions and investment restrictions. It is estimated that up to $100 billion in assistance could be provided to help insolvent multiemployer plans pay retirement benefits.
  - **Permissible Investments:** The Final Rule allows plans to invest up to 33% of SFA funds in return-seeking investments. This includes stocks, 144a securities, and high-yield corporates (that were investment-grade at time of purchase). A minimum of 67% must be invested in investment-grade bonds, such as Treasuries, municipals, fixed-rate dollar denominated bonds, and dollar-denominated emerging market bonds. Leveraged loans, converts, preferred stock, and private credit are not allowed.
  - **Interest Rate Assumption:** The PBGC adjusted the interest rate assumption for calculating eligible SFA amounts, effectively making the investment hurdle rate more feasible for a typical plan. The rate was lowered from 5.3%, or 200bps over the 3rd segment corporate bond rate (which is similar to a 25-year corporate bond rate), to roughly 3.1%, or 67bps over the average of the 1st, 2nd, and 3rd segment corporate bond rate.
- Qualifying plans can use exchange-traded funds (ETFs) or mutual funds to invest SFA grants in investment grade fixed income. However, passive funds are likely not adequate to handle the size – the largest fixed income ETFs are smaller than the total SFA grants. Inflows into these ETFs would be significant relative to their total asset size. Daily inflows and outflows within the iShares Core US Aggregate Bond ETF surpassed $1 billion on just four occasions over the last ten years.
- Multiemployer plans will likely need to utilize active management to efficiently invest any grants received. Active management will allow plans to create custom solutions that align with their unique situation while remaining compliant with the Final Rule's investment restrictions. Additionally, actively managed portfolios can access permissible sectors that are not represented in many passive funds, such as taxable munis and non-index securitized issues.

Sources: Pension Benefit Guaranty Corporation as of 7/18/22 and Bloomberg as of 6/30/22. For a full list of permissible investments under the Final Rule, please reference https://www.govinfo.gov/content/pkg/FR-2022-07-08/pdf/2022-14349.pdf. Right Chart: Each point represents a cusip within the Bloomberg Aggregate Index, excluding Treasuries and any bond with a yield above 12%. Yields are represented as of 6/30/22 are subject to change. Left Chart: ETF asset values listed are of the largest ETFs benched against the Bloomberg Aggregate Index (AGG and BND), the largest full corporate ETF (LQD) and largest long corporate ETF (VCLT). % of Agg axis indicates the ETF's percentage of the Bloomberg Aggregate Index.