Fund

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Important Information from the Board of Trustees of the American Federation of Musicians and Employer's Pension Plan

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This letter provides information developed in response to questions that surfaced since our July 2016 mailing – such good questions, in fact, that we thought it warranted a letter to all participants. Thank you to those of you who asked.

Our History
Over the years, from its inception in 1959 until the 2008 financial crisis, the Fund's assets experienced steady growth. The Fund suffered from occasional down markets, most recently in the early 2000s following the bursting of the tech bubble, but each time quickly recovered. As recently as April 1, 2007, our funded percentage was 107%, which meant that our assets were more than the amount our actuaries told us we needed to cover the Plan's benefit obligations for both current and future pensions. Then, the financial crisis and subsequent recession hit.

Over the 18 months from its peak at the end of September 2007 through the first quarter of 2009, the Fund's assets declined by nearly 40% or about $800 million. A year later, we were in what the Pension Protection Act of 2006 defined as "critical" or "red zone" status. We were not alone in the magnitude of the decline in our assets; almost all multiemployer funds suffered substantial declines.

As required by law, we put a rehabilitation plan in place in April 2010. The rehabilitation plan mandated increased employer contributions and elimination of certain benefits. The Trustees had anticipated this need earlier and lowered the benefit multiplier to $1.00 effective January 1, 2010.

Snapshot of Our Fund – and How It Works
To understand how the Fund works, we need to look at the money coming in and the money going out during the Fund's most recent plan year ending March 31, 2016.

- **Money coming into the Fund**. We have two sources of income:
    1. Employer contributions, which were $63 million
    2. Investment earnings, which were not a positive source of income for this plan year because the Fund experienced a $10 million loss
- **Money going out of the Fund.** There are three categories of "expenses":
    1. Benefits paid, which were $150 million
    2. Administrative costs, which were $14 million
    3. Investment fees, which were $11 million

So for the most recent plan year ending March 31, 2016, we had more money leaving the Fund ($175 million) than coming into the Fund ($53 million) which resulted in a shortfall of $122 million.

With this understanding of how the Fund works, let's back up and look at the five plan years that followed the recession and showed some recovery. Starting in plan year ending March 31, 2010, the Fund experienced gross annual returns of 32.0%, 12.8%, 2.2%, 8.8%, and 8.3% for an annual average of 12.5%. This meant we had a $500 million increase in the market value of our assets (money coming in) as of plan year ending March 31, 2014. However, the amount of our liabilities (or money needed to go out to pay future benefits) also increased in that time period from $2.1 billion to $2.4 billion, as we expected.

The past two plan years have not been as kind as the market value of assets was further dampened by lower returns with a 5.2% return for the plan year ending March 31, 2015 and an essentially flat return (-0.1%) for the plan year ending March 31, 2016.

Making Up the Shortfall

For many decades, pension plans have had the good fortune of using strong investment returns as an adequate source of income, which has been particularly useful to strengthen plans such as ours where the number of people receiving a benefit has increased over the years (money going out) and the number of active participants (money coming into the plan) has slowly declined. For last year, the $122 million shortfall had to be pulled directly from our existing assets since money going out exceeded money coming in and our investment earnings for the year did not cover the shortfall. This gap is widening, which is normal for a maturing plan such as ours, and only became problematic because of the Fund's asset loss during the recession.

Despite having investment returns similar to institutional investors (including pension plans and 401(k) plans) with similar diversified asset allocations, the Fund has an ongoing shortfall because it is constantly paying benefits. That is part of what makes the Fund different from a 401(k) plan that you might be watching over the same period of time. While many 401(k) plans have been able to return to pre-2008 levels, many pension plans have struggled to make up the difference as money goes out of the Plan for benefit payments and Plan liabilities continue to grow.

Investment Return Assumptions

Participants have asked about the 7.5% investment return assumption. They voice concern that it's too high for today's market. The Fund's return assumption is not meant to be an indicator of what we expect each and every year, but is intended as a cumulative annual average over a lengthy time period of 30+ years, through up and down markets. This assumption is reviewed periodically and set by the Plan actuaries after lengthy discussions with the Trustees and with the Fund's investment consultant.

Both the actuaries and our investment consultant use a significant amount of research to determine the expected rate of return for our asset allocation. It allows us to do the kind of financial planning necessary for reasonable long-term pension fund management. For the last 25 years, our average annual return has been 7.5%, net of investment fees.

Fund Investments

Trustees are pulled in two seemingly opposing directions when it comes to Fund investments. On one hand, the Trustees want a high return on the investments to ensure the assets grow at least enough to pay benefits in the future. On the other hand, obtaining higher returns frequently means taking higher risks, which could, depending on the actual investment results, threaten the viability of the Fund and call into question its ability to meet its benefit payment obligations.

We struggle with this dilemma, as do all similarly situated pension boards. The goal is to attempt to devise an asset allocation that maximizes returns and minimizes risks. Our current asset allocation includes the following: equities (domestic, international developed, emerging markets, private equity); bonds (investment grade, high yield and emerging market debt); treasury inflation-protected securities (TIPS); real estate, natural resources and infrastructure. Our domestic equities include core, value and growth and large-cap, mid-cap, small-cap, and micro-cap classes. Trustees, as plan fiduciaries, are required to prudently invest assets. One of the measures of investing prudently is diversifying across different types of investments. So the Trustees generally cannot simply put all of the Fund's assets in one basket such as stocks.

The Fund currently uses 25 professional investment managers with proven long-term track records to manage these assets. To facilitate its oversight of investments, the Trustees have established an Investment Committee composed of five management Trustees and five union Trustees. The Investment Committee relies heavily on the Fund's independent investment consultant and fiduciary in selecting and monitoring each of its investment managers. The investment consultant is responsible for reviewing the Fund's asset allocation, and for providing ongoing advice and specific recommendations to the Investment Committee and the Trustees with respect to the Fund's overall performance and the performance of its managers.

So Where Are We Today?

The Fund has now been in critical status for six years and is projected to remain so for the foreseeable future. Since we cannot increase benefits at this time, the one-dollar benefit multiplier will continue going forward. We currently have a plan that incorporates reasonable measures available under the law to address our situation. At this time, we are reliant on the Fund's investment performance and to a much lesser extent employer contributions.

In December 2014, legislation passed by Congress created a new "critical and declining" funding status, which is applicable to a fund that is critical and is also projected to be insolvent and unable to pay benefits within a 15 to 20 year period. The law provides that plans that are critical and declining may submit an application to the Treasury Department that, if approved, would, with certain restrictions, allow the reduction of benefits already earned in order to better secure the longer-term financial solvency of the plan. These unprecedented reductions could apply to many participants, including some currently receiving pensions and those not yet in pay status. Any such cuts would have to be the minimum cuts needed to avoid insolvency.

While we are not yet in critical and declining status and therefore these measures don't apply at present, the Board has discussed it because it is possible that we will be in critical and declining status in the future, even as early as next year. But the discussions have been challenging for two reasons. First, without detailed knowledge of what the actual finances of the Fund might look like were it to become critical and declining, detailed substantive planning is not possible. Second, there is uncertainty related to the Treasury Department application process for relief when in critical and declining status. Currently ten critical and declining funds have submitted applications for benefit reductions to the Treasury Department; six of these are awaiting decision and four have been denied including an application from one of the largest plans in the country, the Teamsters Central States Pension Fund. For all multiemployer plans facing similar challenges, the absence of any approved application creates uncertainty as to what Treasury might approve.

What Participants Can Do
Finally, many of you have asked "What can we, the participants, do now?" Given our financial status, we are faced with the reality of the one-dollar benefit multiplier as the basis for any benefits earned in the future. This means that while the AFM-EPF pension you receive will still be important, for many the benefit will be a modest one. A modest pension emphasizes the importance of having a comprehensive retirement strategy that includes a personal savings component to supplement the AFM-EPF pension and Social Security benefits.

We hope this letter offers some insight as to the Fund's attempt to address the most difficult problem we have ever faced. Thank you for your questions. We expect to communicate with you further about these issues in the future. For now, the Fund's website at www.afm-epf.org.will be the primary source of information, so please refer back periodically to find answers to frequently asked questions.

Signed,

AFM-EPF Board of Trustees